

# ECONOMICS

## For Everyone



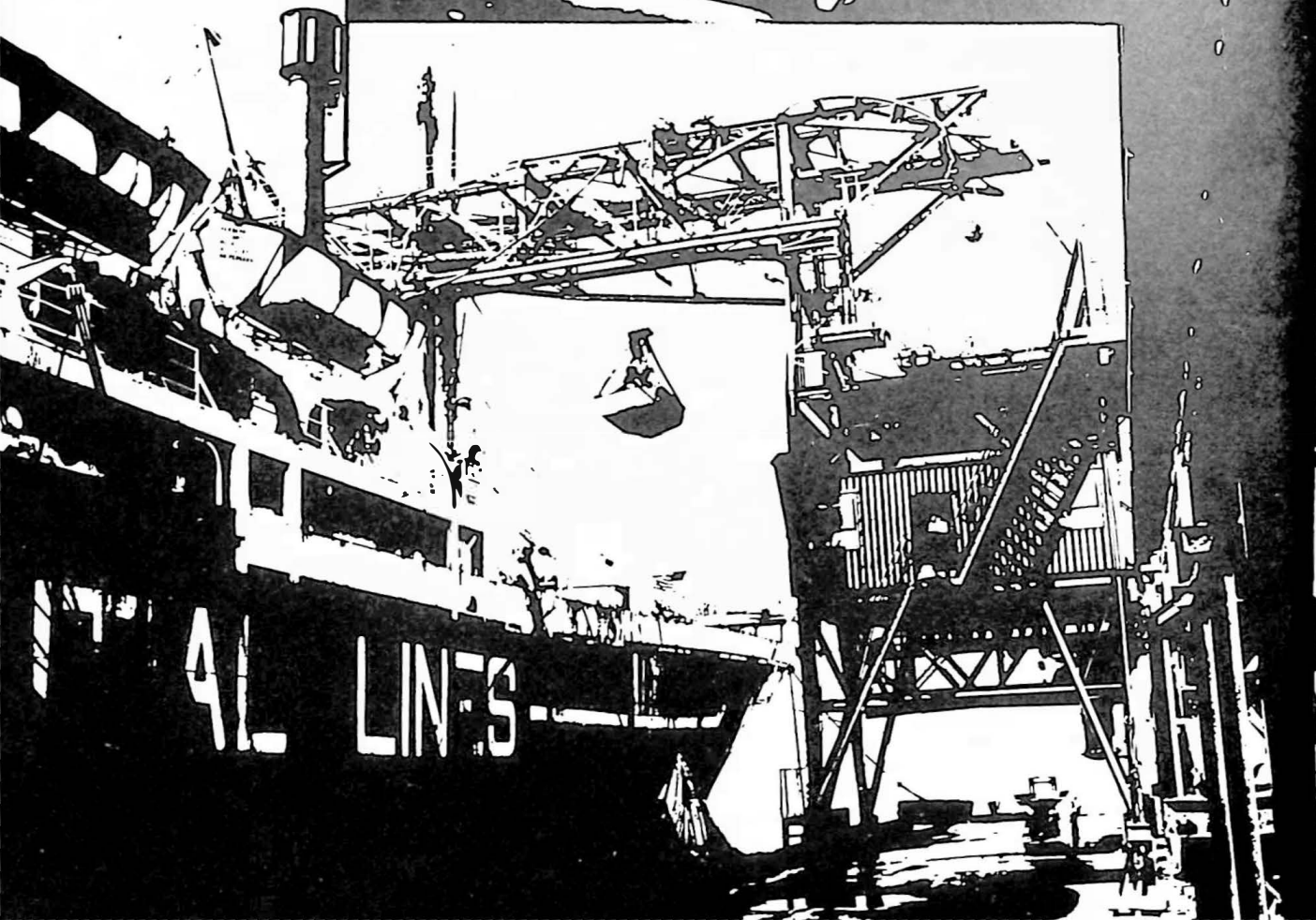
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# ECONOMICS For Everyone

By

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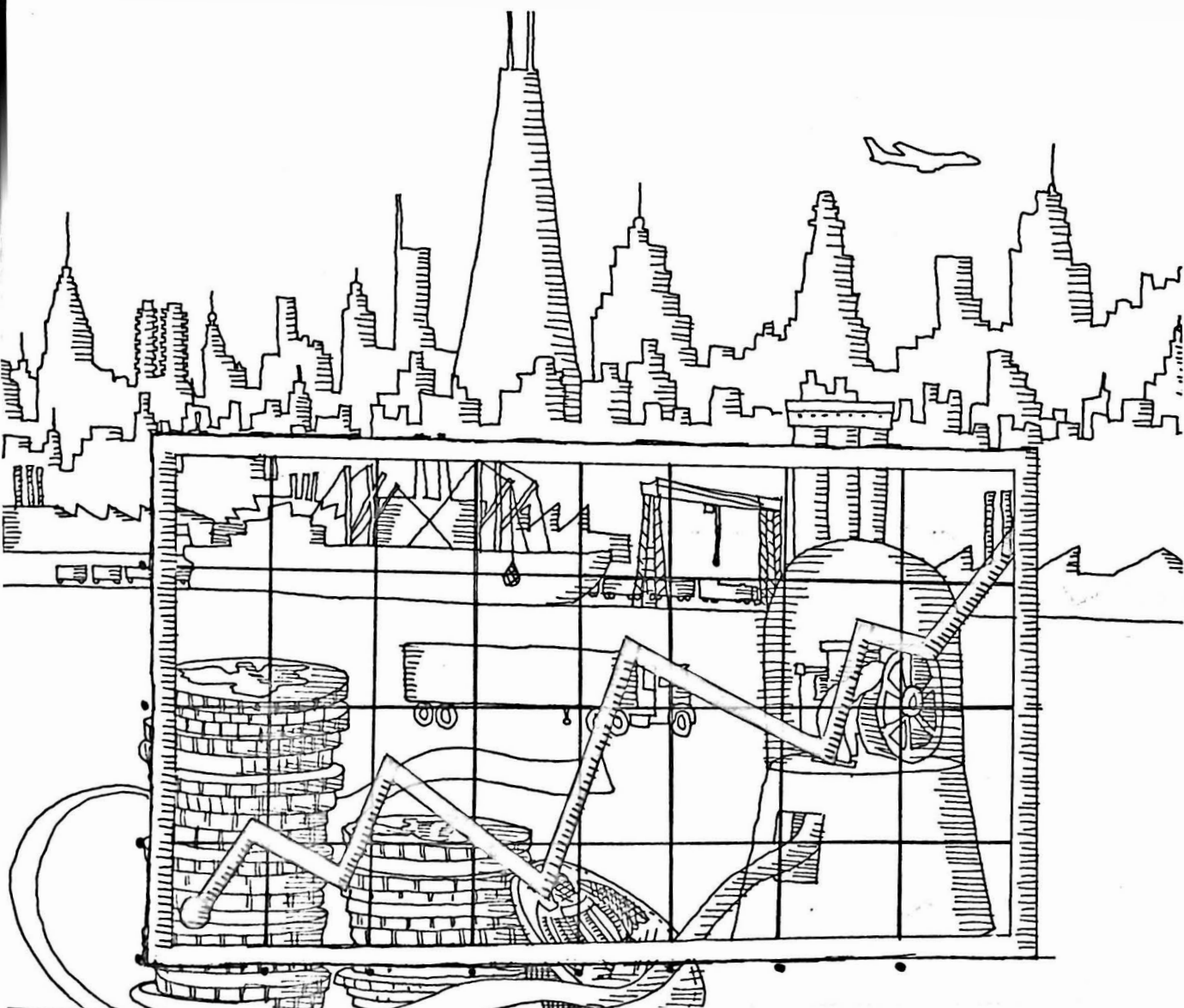
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John Kenneth Galbraith, *The Affluent Society*, Boston: Houghton Mifflin Company, 1958.

# 1. Unlimited Wants and Limited Means

*Economics is a study of man's actions  
in the ordinary business of life.*

Alfred Marshall  
Principles of Economics



## Why study economics?

How many times a day do you have to make up your mind about something? Should I buy a new sweater? Should I go to the basketball game? Will I have the time? Should I save my money for something else? Your decisions may affect not only you, but your family and friends as well. Each of us is faced with decisions and problems each and every day. Many of these are economic decisions.

*Economics* is a study of man's actions in the ordinary business of life. It tells us how man gets his income and how the income is used. What you do to get what you need and want, day in and day out, is economics. When you act to get what you want or need, you become a *consumer*. A consumer is anyone who buys or uses economic goods.

You know that you cannot always do everything that you might want to do. Everything that you do is based upon choices. For everything you do, there are many other courses of action that you could have taken. Have you ever thought about the reasons why you chose to do one thing and not another? This is what the study of economics does. It will help you think about and study the reasons for your choices. It will also help you make better choices for a better future.

All of your choices are choices made between *alternatives*. An alternative is one of two or more

different things between which you may choose. When you make your choice between alternatives, you must think about many things. In the first place, there are limits on the choices that you can make. This is important. If you could have your own way completely, there would be no limit on what you would choose to do. In the second place, there is usually a difference between what you want and what you need.

For example, you might take a bus to a store to buy record albums. If there were no limits on your choice, you might buy all of the records in the store. But there is a limit on your choice. That limit is the amount of money that you have to spend. The limit forces you to make your choice between alternative records. In economics, this is known as the problem of *limitless wants* and *limited means*.

## What is the economic problem?

You find that you have just enough money to buy five records. So you choose five records that you want very much. But wait, you have forgotten something. If you buy all five of the records that you want, you will not have enough money left to pay for the bus ride home that you need.

You must choose between your want for five records and your need for money for a bus ride. In economics this is known as the

problem of *needs and wants*. How much of your limited sum of money should you spend on your need (something you cannot do without)? How much of your limited sum of money should you spend on your want (a *luxury*, something you can do without)?

The problem is the basis for all studies of economics. The fact that you have a limited *income*, or amount of money to spend, forces you to choose between alternatives. This choice between alternatives—between what you need, what you want, and what you can afford—is the *economic problem*. This book will show you some of the ways in which the economic problem can be solved.

Are all people's needs and wants the same?

What do you need to satisfy your basic needs and wants? How can you get what you need? What happens when your needs and your wants are greater than your ability to satisfy them? You are not the first to have to face these questions. Man has always been faced with the economic problem.

For the prehistoric man the choices were fairly simple. His most important need was to stay alive. Early man and his family faced an empty and unfriendly world. There were no supermarkets where they could buy their food. There were no department stores where they could buy their

The men of long ago had to have relatively few things to fill their basic needs.





A modern family today needs many things that were luxuries to many families only fifteen or twenty years ago.

clothes. They found no hardware stores where tools and weapons could be bought. They had no comfortable homes to protect them from heat and cold.

Prehistoric men were faced with the problem of trying to satisfy their most basic needs for food, clothing, and shelter on their own. They satisfied these needs not only through hard work, but also through the efforts of their minds. This ability to satisfy needs is what set early man apart from other animals. The desire to satisfy needs in better ways helped early man progress from the cave.

**How can your wants be described as unlimited?**

The cave man was satisfied to fill his needs by killing animals

for his food, using their skins and furs for his clothing, and finding a protected cave or other natural shelter to live in. Provided with basic needs, or *necessities*, man survived. But providing for the necessities was only the beginning of man's economic life.

Once man's basic needs were provided for, there was no end to the number and the variety of his wants. Man's list of wants was ever-increasing. His list of wants has continued to grow right down to the present day.

Look at yourself. You can see that you are not satisfied with simple necessities. Make a list of the things that you consider to be your basic needs. What are the things that you feel that you could not do without?

Compare your list with those of other students in your class. You will see that some of the same things will appear on all of the lists. There will also be many things that will be different from list to list. Many of the things will have nothing to do with food, clothing, and shelter. You want and need many things that man does not need in order to survive. For you the car, the television set, and the stereo record player may have become needs.

Moreover, you want and need not only *economic goods*, but also *economic services*. Economic goods are material objects such as books, clothes, cars, and television sets. Economic services are work done without producing material objects. The people who sell the books, alter the clothes, repair the cars, or produce the television programs are providing an economic service. Throughout the

book, when we talk about economic goods, or consumer goods, we will also be including economic services. As you can see, as man has become more advanced, his wants and needs have become much more complicated.

Different people satisfy their needs in different ways. In some social groups people like hamburgers, while in others they would much rather have fish, frog legs, or whale blubber. In some parts of the world people live in houses or apartments. In other places they live in tents, grass shacks, or igloos. The clothing worn by an Eskimo in the arctic would not be useful for work on a tropical sugar plantation or in a Detroit automobile factory. You would not expect a third grade student to enjoy just what you do. These differences may be caused by geography, by culture, by age, or by differences between people.

Our society needs a great variety of both goods and services just to keep operating on a day-to-day basis.





What are the needs of man?

How does each satisfy his needs?

What needs are the same for all of these people?

Why is there a difference between ways needs are satisfied?

What might some of the wants of each be?





When we make an economic decision, we must always choose carefully what to buy and how much to spend.

**How are the means for satisfying your wants limited?**

Although there is no limit to your wants, most of the means for satisfying those wants are limited. A few things such as sunshine, water, and fresh air cost nothing. But you must work for and earn almost all of the great number of things that you want.

Since most of your wants are limitless, you will never be able to get everything that you want. You will be forced to choose between a number of different things that you want. Your choice will be based upon two things. They are: (1) *preference*, or what you want the most, and (2) *income limit*, or what you can afford to pay.

When you choose between alternatives and your choice is based on preferences and income limits, you are acting economically. In

fact, most of the problems which face you daily are economic problems and need economic solutions. To study your problems from an economic point of view and to arrive at economic solutions, you must have an understanding of economics and economic methods.

**What is the problem of unlimited wants and limited means?**

The subject of economics is concerned with how to use your limited means to satisfy your limitless wants. It should be clear by now that all of your wants cannot be satisfied. Your ability to satisfy your wants is limited by the amount of your *resources*. Your resources may be the money you have to spend or your time to do something. For every want you choose to satisfy, you must give up other things that you want just as much.

The problem is made even more difficult by the fact that most of your limited resources can be used for many different things. For example, the same hour of your time can be used to listen to records, watch television, or call your boy or girl friend. If you use the hour to make your phone call, you cannot also use it to watch television or listen to records. For such reasons, you must decide how to use your limited resources wisely and carefully.

What are some of the methods and tools used by economists?

Solving a problem and making a decision can be an exciting adventure. If the problem is an economic one, its solution often becomes a necessity. There are

many different ways of solving problems. The way that you will learn here is the *economic method*. You are solving a problem by the economic method when you choose the best alternative from among several different choices. Your choice will always be limited by the fact that your resources are also limited.

Suppose, for example, that you receive an amount of money each Sunday morning. On this Sunday evening you have the choice of watching television, going out with your friends for a pizza, or studying for the American history test which you are going to take tomorrow. Your allowance for this week is fixed. If you spend any money at all on Sunday, you will not be able to go out Friday.



Furthermore, television or a pizza party on the night before the test will probably leave you tired and unprepared for the Monday history test. The penalty for not studying on Sunday evening (not passing your history test) becomes greater than the loss of pleasure you would suffer by not going for a pizza or not watching television. From the economic point of view, your choice should be to study on Sunday evening and use the money you saved to go to a movie or a dance next Friday. The choice is up to you.

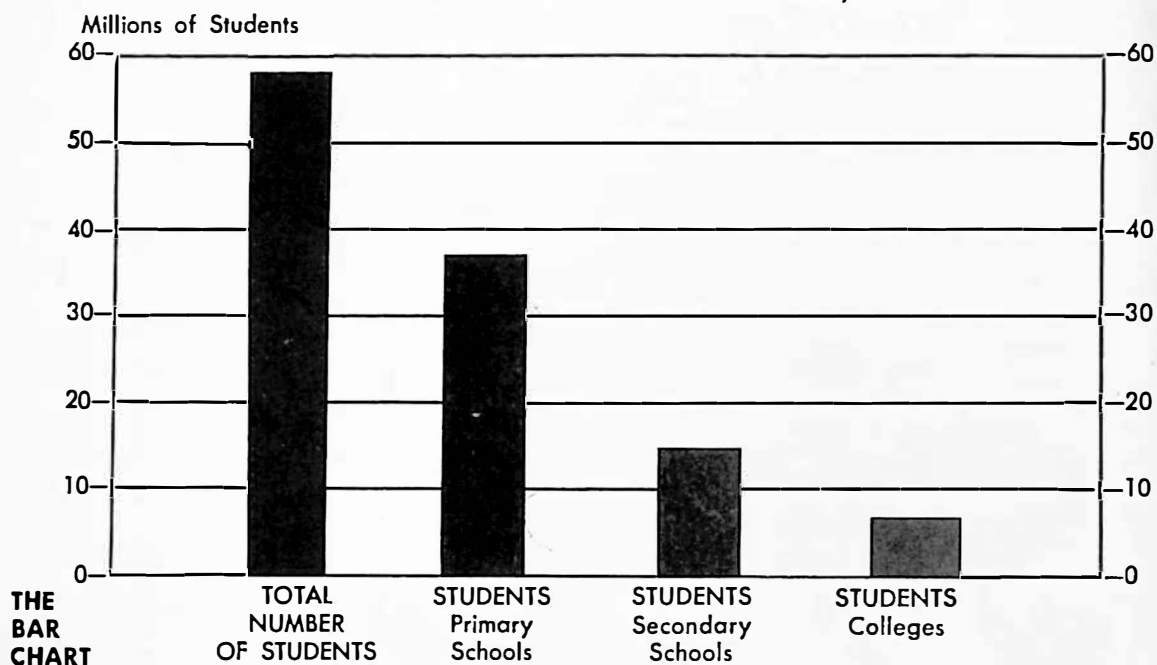
Our parents' desire for a new home in the future means they will have to put off many purchases today.

Your family and your nation are often faced with very similar problems. Your parents may want to buy a new car now and a new home next year. Both of these things are very expensive and your family's resources, their income and savings, are limited. If they buy the car today, buying a home will have to be put off for even longer than a year. What should they buy? A house may cost more next year. Their present car may need expensive repairs if they keep it longer. An economic decision will have to be made.





SCHOOL ENROLLMENT IN THE UNITED STATES, 1969



Source: U.S. Bureau of the Census.  
(All figures rounded to the nearest million)

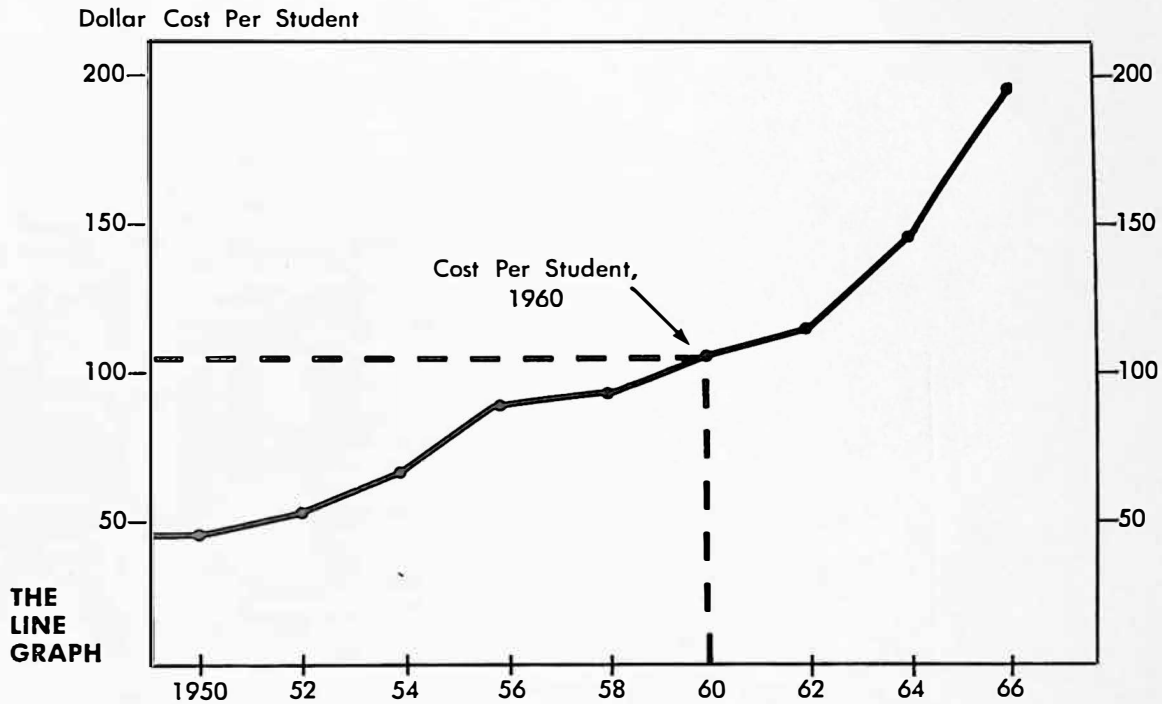
The simple bar chart uses a thick line or stripe (bar) as its means of measurement. The units to be measured are arranged horizontally at the bottom or base of the chart. The measurements are arranged vertically along the left and right sides of the chart.

In our example, the bar chart shows school enrollment in the United States in the year 1969. Arranged along the bottom of the chart are population groups to be measured (number of students in schools of various grade levels). Arranged up the left and right sides of the chart are the numbers measuring the number of students in the United States, in millions, in 1969. Each bar shows the number of students in a particular group.

You can read the bar chart very easily using either a ruler or a piece of paper. Place the ruler or paper horizontally across the top of the bar showing the number of students enrolled in secondary schools. Your ruler or paper crosses the left side of the chart at 14 million. This is the number of students enrolled in secondary schools in 1969.

Now read the number of students enrolled for all other groups measured. How many students were enrolled in colleges in 1969? What was the total school enrollment in the same year? Using the bar chart, can you find the difference between the number of students enrolled in primary schools and the number of students enrolled in secondary schools?

THE INCREASING COST OF EDUCATION:  
State and Local Expenditures Per Student



Source: U.S. Bureau of the Census.

A second commonly used economic tool is the line graph. Line graphs are generally used to show changes over a length of time. Basically, a line graph is a diagram on which a number of dots have been placed. These dots represent the information to be studied in the graph. Once placed on the diagram, the dots are connected with a line. The changes in the direction of the line will help you find the changes that have taken place in the information you are studying.

The direction of the line in the example will enable you to understand that, after more than fifteen years of slow and steady increases, the cost of education has begun to

rise sharply in the last few years. To find the cost per student for any year, first find the dot which is placed on the diagram above the year. Then place a ruler or sheet of paper horizontally across the dot. If you do this for the year 1960, you will find that the cost of education per student for that year was about \$105.00.

The costs of education per student in any year listed on the chart may be read in the same way. What was the cost per student for the year 1956? What was the last year in which the cost per student was less than one hundred dollars? In what year did the cost of education begin to rise much more sharply?

A table is an orderly arrangement of information in rows and columns for easy reference. The title of a row (horizontal position) is a *stub*. The title of a column (vertical row) is a *caption*. In the table below the words at the left, such as "total pupil enrollment," and "number of students" are stubs. The words and years at the top, such as "number (millions), 1960," are captions.

The table is the easiest of the basic economic tools to read and to understand. To find out what the total pupil enrollment was in the year 1970, first find the stub titled, "Total Pupil Enrollment." Lay a ruler or sheet of paper under that word and across the row. Then find the caption "1970" and

look down the column. You can read the answer, 59 million, as shown just above your ruler. Can you find the number of high school students in the year 1960? How many were there? How much was the increase, in percent, of secondary school teachers from 1960 to 1970? You may now go on and read all of the information in the table.

There are many other tools which economists use in their efforts to solve economic problems. These three, however, are all that you will need to know now. If you study each of them carefully, and are able to understand them, they will be of great help to you as you try to understand and then solve your economic problems.

#### EDUCATION IN THE UNITED STATES, FROM 1960 TO 1970

U.S. Educational Highlights	Number (Millions)		Percentage Increase	Total Pupil Enrollment, 1970
	1960	1970		
Total Pupil Enrollment	45.8	59.0	+29%	
Number of Students Primary	32.5	36.6	+13%	
Number of Students Secondary	9.7	15.0	+55%	
Number of Students College	3.6	7.4	+106%	
Classroom Teachers Total	2.0	3.0	+50%	
Classroom Teachers Primary	1.0	1.2	+20%	
Classroom Teachers Secondary	.6	1.0	+67%	
Classroom Teachers College	.4	.8	+100%	

THE TABLE

Source: The National Education Association  
(All figures rounded off)

## THE PRESIDENT SPEAKS ABOUT THE ECONOMIC CONDITION OF THE NATION

Document 1: In the *Economic Report of the President*, January, 1969, President Nixon outlines some of the economic problems facing the nation. He also explains what the goals should be.

### QUALITY OF THE ENVIRONMENT

More than ever, Americans realize that purposeful action is required to ensure an environment we can all enjoy. In the last 5 years, legislation has been enacted to abate air and water pollution and to control the disposal of solid wastes. Despite progress, many of our rivers still are open sewers, our atmosphere often unfit to breathe, and much of our land littered with discarded junk. We must

- develop new methods for financing water treatment plants,
- attack oil pollution of harbors and beaches,
- strengthen laws for clean air and solid waste disposal,
- stop the ravages of strip mining, and
- preserve more parks and wilderness areas.

### COMMUNITY DEVELOPMENT AND HOUSING

Rapid population growth in our cities and rising living standards have created a backlog of community and housing needs.

Local governments are finding it increasingly difficult to finance essential community facilities—schools, parks, hospitals, and transportation systems. The Federal Government must develop new ways to help communities raise capital for public facilities.

The capacity of the housing industry must be enlarged and updated to meet the Nation's goal of adding 26 million decent homes and apartments over the next decade.

To improve our communities and meet our housing needs, I recommend

- an independent, federally established, Urban Development Bank to provide low-interest loans to State and local governments,
- increased Federal research and development to improve construction technology,
- a Federal program to test housing materials and to improve building standards and practices,
- the training of more construction workers through federally assisted manpower programs in cooperation with trade unions and contractors, and

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- increased Federal research and development to improve construction technology,
- a Federal program to test housing materials and to improve building standards and practices,
- the training of more construction workers through federally assisted manpower programs in cooperation with trade unions and contractors, and

- an urban mass transportation trust fund, financed by a portion of the automobile excise tax.

## EDUCATION

Providing good education is a national responsibility in which the Federal Government must do its part. Great progress has been made in recent years toward our goal of providing every child all the education he wants and can absorb. But continued and expanded efforts will be needed. This Nation must strive to

- provide every child with year-round opportunity for preschool education,
- offer every teacher assistance for continuing education,
- bring the cost of higher education within the means of every qualified student through expanded loans and grants, and
- provide funds for higher education adequate to ensure instruction of finest quality.

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## THE GOVERNMENT TRIES TO LIMIT POLLUTION

Document 2: This article, describing new federal requirements to limit pollution from automobiles, appeared in the July 27, 1970, *Wall Street Journal*.

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A major battle is brewing between Government and industry over proposed new Federal requirements aimed at limiting pollution from motor vehicles.

Federal regulators recognize privately that the auto companies may find it difficult...to meet the standards proposed for many of their 1972 model cars. But the...Administration, in its campaign to clean up the environment, has deliberately decided to adopt a hard line and force the industry to take the onus [blame] for any delay.

The car companies have...made their criticism clear to the National Air Pollution Control Administration, which issued the proposals earlier this month... "I can state flatly that there is no possible way in which the requirements can be accomplished by the 1972 model," insists an engineer for a "Big Three" company.

The conflict is sure to be embarrassing for both sides. The auto companies have complained in the past of the impossibility of meeting new Federal emission-control requirements and then have met them when forced to. Federal regulators, on the other hand, have tended to cautiously tailor the requirements to industry's technical capacities and have been increasingly criticized for softness by consumer groups and Congressmen...But for the first time in recent years, it's clear that the pollution agency, with backing from the White House, has issued requirements that may in fact be too difficult to meet.

## DO WE REALLY WANT POLLUTION CONTROL?

Document 3: From an article appearing in the July 30, 1970 issue of the *Wall Street Journal*.

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Clean air may be good for you, but if you have to voluntarily shell out \$20.00 to help get it, chances are you won't bother.

At least that's one conclusion that can be drawn from a two-month test-marketing effort by the General Motors Corp. of its recently announced used-car pollution-control kit...GM disclosed that in the two months starting May 15, owners of only 528 of an eligible 334,000 pre-1968 cars in the Phoenix area elected to have their automobiles equipped with the kit, despite what GM calls an "extensive and thorough" promotion program that included billboard, newspaper, radio and television ads.

A GM source in Phoenix said the company spent more than \$50,000 trying to promote the kits. On this basis, it cost GM almost \$100 for every sale it made. The source termed the project's results "discouraging."

The ratio of owners who had the kit installed was less than one in 600...GM has previously stated that its used car antipollution kit can reduce emissions from older cars by up to 50%.

### Using Economic Methods

1. Find examples of at least three economic problems in the document, "The Economic Report of the President."
2. Give examples of economic decisions that you might have to make during the school week.
3. Using a blank piece of paper and a ruler, prepare a bar chart showing your personal expenses for one week's time.
4. Using a blank piece of paper and a ruler, prepare a line graph showing the amount of time you spent watching television each day for the period of a week. Now make a line graph showing your time spent studying. Compare the two.

# ˌek-ə-ˈnäm-iks/

## Knowing Your Vocabulary

*economics* /ˌek-ə-ˈnäm-iks/

The study of how man earns his income and how he spends it to get what he wants or needs. 9

*consumer* /kən-ˈsü-mər/

Anyone who buys or uses economic goods and services. 9

*alternative* /ˈol-ˈtər-nət-iv/

One of several different things between which you may choose. 9

*luxury* /ˈləksh-(ə)-rē/

Good which people do not need and can easily do without. 10

*necessity* /ni-ˈses-ət-ē/

Something that we cannot live without. 11

*economic good* /ˌek-ə-ˈnäm-ik ˈgūd/

Material object produced for use or sale. 12

*economic service*

/ˌek-ə-ˈnäm-ik ˈsər-vəs/

Useful work without producing material objects. 12

*preference* /ˈpref-ərən(t)s/

What you would want most of several different choices. 14

*income* /ˈin-kəm/

The money you earn. 10

*resource* /ˈrē-sō(ə)rs/

Something that is available to man for his use. 14

*economic structure*

/ˌek-ə-ˈnäm-ik ˈstræk-chər/

All of the things that make up the business life of a nation. 17

*statistics* /stə-ˈtis-tiks/

The science which collects, arranges, and presents great amounts of information in such a way as to make their study easier. 17

*bar chart* /ˈbär ˈchärt/

An economic tool which measures information through the use of lines or stripes called bars. 17

*line graph* /ˈlīn ˈgräf/

An economic tool which measures information through the use of a series of dots connected by lines on a graph. 17

*table* /ˈtā-bəl/

An orderly arrangement of information in rows and columns for easy reference. 17

*stub* /ˈstəb/

The title of a row of information in a table. 20

*caption* /ˈkəp-shən/

The title of a column of information in a table. 20

## Reading the Text

1. What is "economics"?
2. What is the "economic method"?
3. Name three important economic tools.
4. What is the difference between an economic need and an economic want?

## Debating and Discussing Ideas

1. The President spoke of the needs of education in his Economic Report. What do you think the needs of education have to do with economics?
2. Turn back to the bar chart, line graph, and table that were given as examples in this chapter. From the information you can find in those examples, why do you think that education is becoming an economic problem?
3. A second economic problem which the President brought up in his report was the pollution problem. What did he say about the problem? How do you think he should go about solving the pollution problem? What part can you play in the solution of this problem?
4. Document 2 discusses new federal requirements for cars. These requirements would limit pollution created by cars. Why do you think the government has passed some anti-pollution laws that are so strict that the automobile companies will be unable to live up to them?
5. Documents 1 and 2 told you that air pollution is a major concern of all Americans, and that the government intends to do something about the poisoning of the air. What does Document 3 tell you about the concern of the average citizen with pollution? Why do you think that this is the case?
6. How and why, do you think, is environmental pollution an economic problem?

## Reading Other Sources

Glassner, Sherwin and Grossman, Edward. *How The American Economic System Functions*. Westchester: Benefic Press, 1968.

Robinson, Marshall, *et al.* *An Introduction To Economic Reasoning*. Washington D.C.: The Brookings Institution, 1967.

Feinberg, Daniel. *Consumer Economics*. New York: Holt, Rinehart and Winston, 1964.

## 2. Consumer Demand

*Demand: The quantity of a good that people will buy at one time depends on price; the higher the price charged for an article, the less quantity of it people will be willing to buy; and other things being equal, the lower its market price, the more units of it will be demanded.*

From Economics, An Introductory Analysis, by Paul A. Samuelson. Copyright 1961, McGraw-Hill Book Company. Used with permission of the McGraw-Hill Book Company.



**What is the importance of the question "Why?"**

Why do you choose to buy certain kinds of goods, and certain brands of goods, and not others?

Before you read further into the chapter, make a list of the reasons why you bought the last thing that you bought. Why do you think you wanted it? Why do you think you needed it? Why did you choose the brand that you did?

Compare the list you made with lists of your classmates. How many different reasons for buying goods can you find from list to list? Keep these many reasons in mind as you read the chapter. They will help you understand the many things that are part of your decision each time you choose to buy, or not to buy, a good.

**Why do you buy goods?**

The main reason you buy goods is to satisfy your needs or wants. Sometimes these goods are *necessary goods*. Necessary goods are those goods which you need and cannot easily do without. Necessary goods are used to satisfy your basic needs for food, clothing, and shelter.

Sometimes the goods that you buy are luxury goods. Luxury goods are goods which you want, but can more easily do without.

There are no simple lists of luxury goods and necessary goods which you can study to see the difference between the two. A good which is a luxury to you

may be a very necessary good to someone else. A good which is necessary to you may become a luxury good to another person.

An automobile, for example, is a luxury good in many parts of the world. Yet, for your father or mother it might be a necessary good. Your father may depend upon it to get to work. He may not be able to earn his living without an automobile. Your mother may need it to do her shopping. She may not be able to provide dinners for the family without the use of an automobile. For them, the automobile has become a necessary good. They would find it almost impossible to get along without it.

Can you think of any other goods which may be necessities for you and your family, but would be luxuries for other people? Can you think of any goods which may be luxuries for you and your family, but would be considered necessities for other people?

Most people want both necessary goods and luxury goods. This desire for goods, along with the ability to pay for them, is called *consumer demand*.

**What influences your choice between goods?**

Although people have different needs and preferences, they all have such basic needs as food, clothing, and shelter. The goods which are necessary for you to stay alive fill your basic needs.

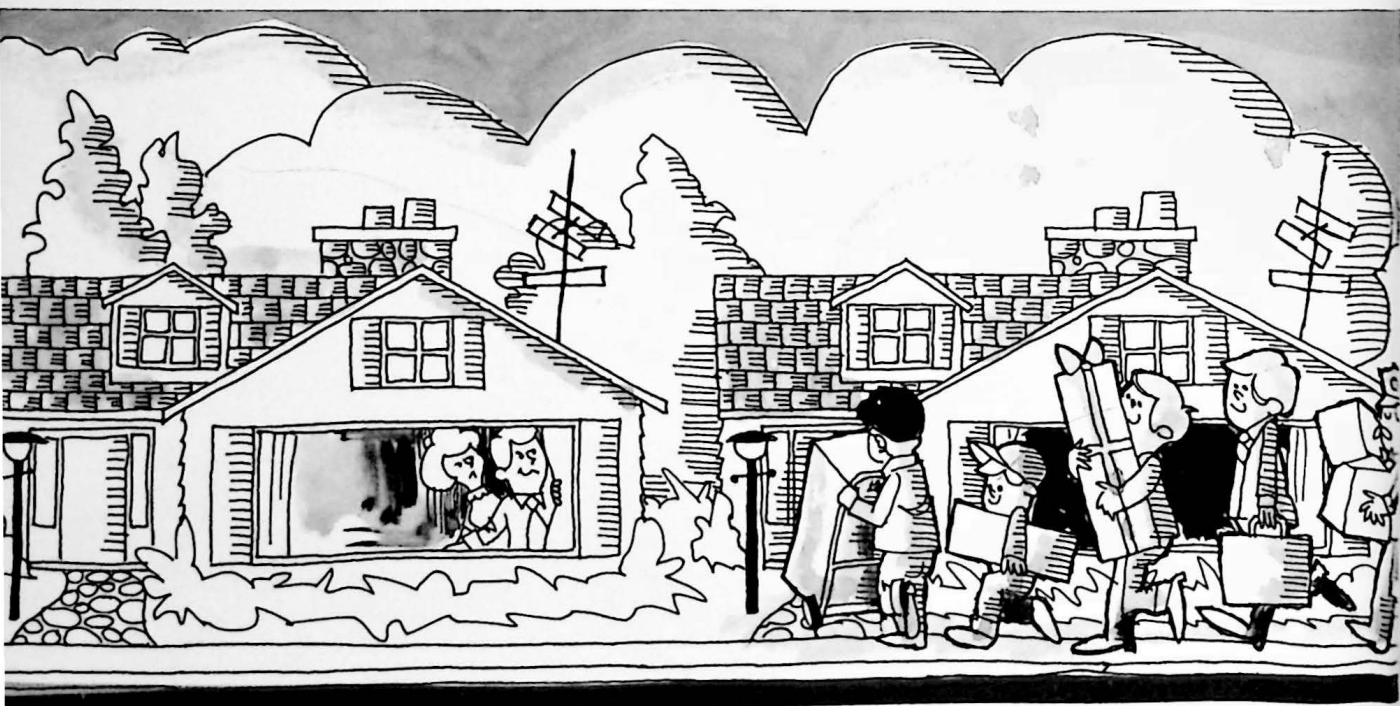
But after your basic needs are satisfied, your preferences are very changeable and differ greatly. You want many different kinds of goods. You may want toothpaste, a record, a sweater, or a candy bar. Also, you may want variety within each kind of good. You want to be able to choose from among many different kinds of toothpastes, records, sweaters, and candy bars.

Why do you, the consumer, choose one good over another on which to spend your money? Further, why do you choose a certain brand name of good? The simple answer is that you prefer one good over all of the others.

But why do you prefer it? One of the things which influences

you is the price. You may prefer the good because it is low-priced and within your income. Or you may prefer one good over others because your friends also prefer that one.

Another reason for buying a certain good is because you want to impress your friends or your neighbors. This desire to impress leads to what a famous American economist, Thorstein Veblen, called *conspicuous consumption*. He used this term to describe a "showy" display of wealth—that is, persons buying just to impress others. Some people think that the more a good costs, the better the good must be. This is why people sometimes base their preferences on nothing but the cost of the good.



As you can see, there are several different reasons why you may prefer one special good over another. Furthermore, when you choose to buy a certain good, you probably make your choice for several of these reasons at the same time. For example, you may decide to buy a certain good to impress your friends. But the quality of the good that you purchase may be limited by the amount of money that you have to spend.

However, behind all of the reasons that influence your choices, there is one other reason. This final reason is almost always a part of all the other reasons you may have for preferring one good over another. You may prefer one good over another because you are influenced by *advertising*.

#### What is advertising?

Like most consumers, you have no inherited desire for the different kinds of goods that you may purchase. You were not born with a desire for a certain dairy's milk, or a certain company's candy. It is the job of advertising to try to make you want a particular product or brand.

Advertising comes in many different forms. It may be a television commercial designed to convince you that only by using "Brand X" will you be popular with your friends. It may be a newspaper advertisement for automobiles promising "the lowest prices in town." Or it may be a simple



"Get the message???"

sign over a restaurant advertising "the best food in town."

No matter what form it takes, no matter what product it shows, advertising has one job to do. That job is to make you want to buy the product that is being advertised. Very clever people think up these *commercials*, or advertising messages. The people, together with the methods they use, are called "Madison Avenue." This is because many of the most important advertising companies are located on Madison Avenue in New York City.

There are many methods that are used by Madison Avenue to convince you to buy the product they are advertising. One of these methods is the *endorsement*.

**"Our Maytags haven't taken a time-out in 6 years," write Mr. and Mrs. Mel Renfro.**



*"They haven't needed one repair, even though my Maytag Washer and Dryer do seven or eight loads a week," says Pat, wife of the Dallas Cowboys' football star.*

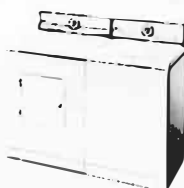
If they had a Pro Bowl for washers and dryers, Maytags would surely be starters, according to the Renfros. They should know. Mel started in his himself now, joining the Dallas Cowboys, after starring on the University of Oregon's football team.

"We bought the Maytag Washer and Dryer we have in our home in Dallas, Texas, in 1964," says Pat. "They have never let us down. We haven't spent a cent for repairs in six busy years."

Mrs. Renfro isn't too surprised at how well her Maytags stand up to hard work. "My mother had a Maytag for many years. I grew up with that machine, and I know it was a good one."

Today you can get New Generation Maytags with all the latest features. A washer with giant capacity tub. A Maytag Halo-of-Heat® Dryer with Electronic Control. Both have Maytag's special Permanent-Press Cycle.

We don't say all Maytags will equal the record Mr. and Mrs. Renfro reported. But dependability is what we try to build into every Maytag.



**What is an endorsement?**

Young people often identify with famous people. How many times have you imagined yourself to be a super-athlete, or a famous dancer, or a great rock singer? Advertising tries to take advantage of this desire of young people to identify with great or famous people.

A magazine advertisement might suggest to you that if you eat "Strongo" bread, you could become a super-athlete, as many famous professionals have. The advertisement may have a statement by an athlete saying that he eats "Strongo" every day. He suggests that

"Strongo" may be the reason for his success. He advises you to eat "Strongo," too.

This recommendation by a famous person, for which that person is paid, is called an endorsement. Can you make a list of all of the products that you have purchased recently that had the endorsement of some famous person? Do you think that endorsements make any difference to you when you are going to buy something?

**How are you influenced by the brand name?**

A second method used by advertisers is the influence of the *brand name*. A brand name tells you that the products you are looking at were made by a particular company. Each company has its own brand name or names. Each brand name is registered with the federal government. It is against the law for any company to use another company's brand name.

The brand name is one of the best ways to advertise a product. It has always been a very successful way of selling a product. Through advertising, you are constantly exposed to the brand name. You are told that this brand always means something that is well made and of the best quality.

By making statements over and over again, the advertising men hope that you will begin to believe them. Their aim is to make you connect the brand name with high quality. One large company

says that, "Our products are the very best." Another company advertising its brand says, "If it isn't the best, we haven't thought of it yet." Both companies sell excellent products. But it is possible that other companies will sell products which are just as good, or perhaps even better.

Sometimes a brand name becomes a symbol of *prestige*, or importance and high standing. Someday you might decide to buy a very expensive brand of car. Perhaps you will buy this car because it is well made and will last much longer than a cheaper car. But it is just as possible that you will buy it because you believe that ownership of this car will help increase your prestige in the community.

An important job of advertising men is to try to make the product that they are advertising into a prestige product. A clothing company advertises "the suits worn by the stars." A furniture company claims that its products are "seen only in the best homes." Advertising men know that consumers often buy certain brands just for their prestige value.

Can you think of any products that depend upon the symbol of prestige in their advertisements? Have you ever bought a product because of its prestige value? If so, make a list of the goods that you have purchased because of their prestige value. Do you think this is a wise reason for buying?

As you can see, the claims made by advertisers are not always the complete truth. They are not meant to be. These advertising claims are not made only to inform you about the product. They are made to influence you to buy the product. The excellent quality which they advertise may or may not be the truth.

The consumer must study advertising claims very carefully. Fortunately, the consumer is aided in this by the Federal Trade Commission (F.T.C.). The F.T.C. is a government agency which studies the claims made by advertisers. The F.T.C. tries to make sure that advertising claims are true. It helps the consumer decide on the merits of advertising claims.

How is consumer demand satisfied?

You have learned about some of the things which influence consumer demand. But consumers must have something to buy. Goods do not produce themselves. They must be made and then sold by people. These people are the producers and providers of economic goods and services. Producers and consumers together make up the economic structure—the *economy*—of the nation. The economic structure provides for exchange of goods and services between the producers on the one hand and the consumers on the other. How these goods and services are provided is an important part of the story of our country's economics.



Management: the coordinators of the functions of land, labor, and capital.



Land: the raw materials of production, the resources of the earth.

Goods and services are produced through the interaction of the *factors of production*. The factors of production are *land, labor, capital, and management*. Land is the physical earth and all its natural resources. Petroleum, iron ore, and water are just a few of the resources which may be used in production. Labor is human services which are used in production. It makes no difference whether this is the productive effort of the day worker, the chemist in the laboratory, or the secretary in her office.

Capital is goods produced by humans to aid in the further production of other goods. Capital is not used to satisfy human wants

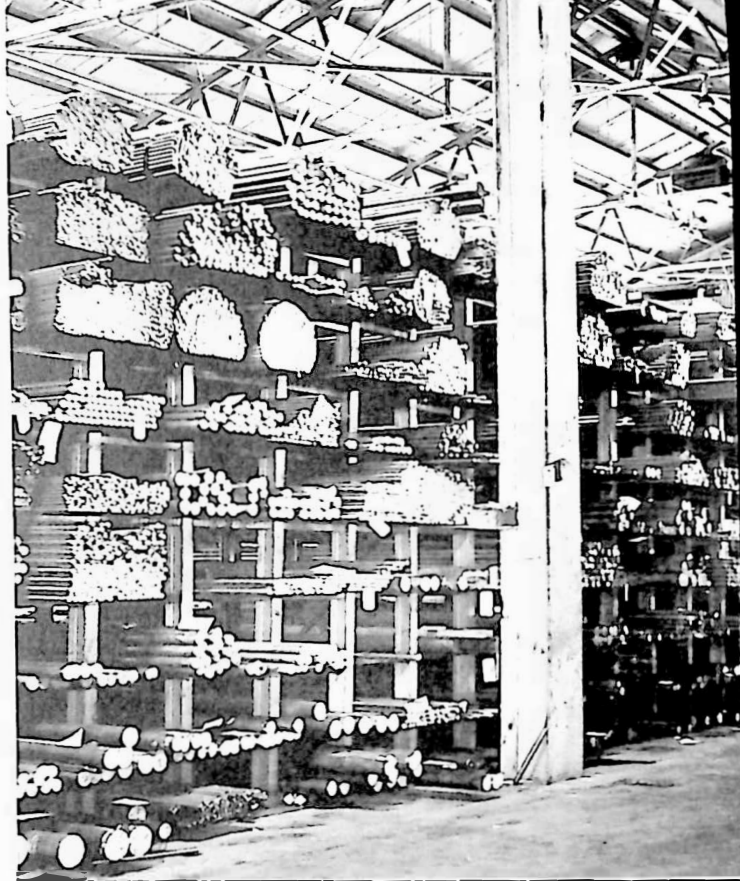
directly. A factory building, machinery, bales of raw cotton, and unsold merchandise are capital. Businessmen value their capital in money terms. They may say, for example, that a corporation has capital of one million dollars.

Management is the group of people who control and direct the activities of labor, capital, and land. The factors of production, working together, produce the many goods and services which are needed to satisfy the demands of the consumer.

But this is not the whole story. Firstly, how can those who direct the production be sure that they are producing just those goods and services that you, the consumer,



Labor: the efforts needed to transform raw materials into useful goods.



Capital: goods that will be used in the production of other goods.

want and need? Who is there to tell them that so many pairs of shoes or so many color television sets will have to be produced this year? Secondly, why do those who direct production go to the trouble of producing goods and services for the buyer?

Why is consumer demand satisfied?

The economic structure which you live in is called a *market economy*. A market economy is one in which goods and services are sold to the buyer with the highest bid. Every time that you choose to buy a good, you are bidding on it. The goods and the services that the greatest number of consumers bid on, or demand, are the goods and

services that many thousands of producers and sellers will supply to the public.

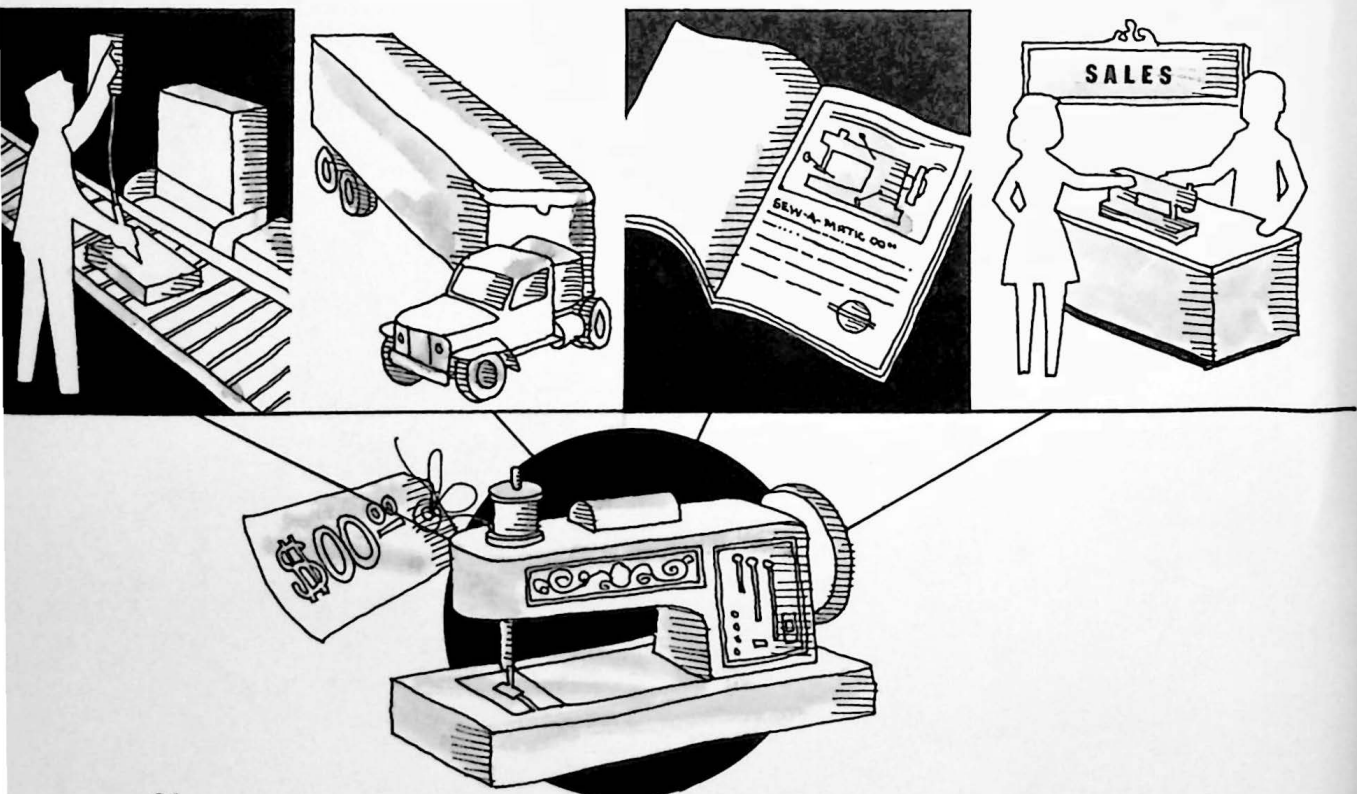
Usually the market is *competitive*. There are several people competing to sell the same good. In a competitive market, the price of the good will depend on two things. One is the amount of goods that sellers will offer for sale at different prices. The other is the amount of money that you and the other consumers are willing to bid for different amounts of goods. This process in economics is known as the *law of supply and demand*. In the following section, we will see how supply and demand determine the prices at which goods are bought and sold.

If consumers buy more of a good, the price of the good will go up. Producers will offer to sell more goods at the higher prices. If consumers buy less of a good, the price of the good will go down. Producers will not want to sell as many goods at the lower prices. Some producers may even go out of business. Other producers will gradually turn to producing goods for which consumer demand is high. In general, if consumers buy more goods, the price goes up and the amount that producers offer for sale goes up. If consumers buy less goods, the amount that producers offer for sale goes down.

Producers and sellers are willing to obey the law of supply and demand because of the *profit motive*. Profit motive is the main

reason why businesses operate. Everyone who is in business wishes to make a profit. Profit is the money that is left over after all of the costs of making, transporting, advertising, and selling goods have been subtracted.

If prices are very low, producers will not be able to pay for their costs and will be forced to go out of business or produce some other good on which they can make more profit. If prices are very high, producers will increase production as much as possible. New businesses will be formed to produce this profitable good. Producers of less profitable goods will gradually shift to the production of the good on which they can make more profit. The price of a good, then, is very important.



How is the price of a good determined?

If you wanted to get a haircut, purchase a new automobile, or buy a pound of tomatoes, each of these items would have a price that you would have to pay. Every good offered for sale has a price. But how is the price decided?

Suppose that you were a tomato farmer. What would set the price that you would receive for your tomatoes? The price that you will receive for your product is determined by the number of people wanting to buy and sell. The larger the number of tomato farmers competing with one another, the lower the price will be. The larger the number of customers who want tomatoes, the higher the price.

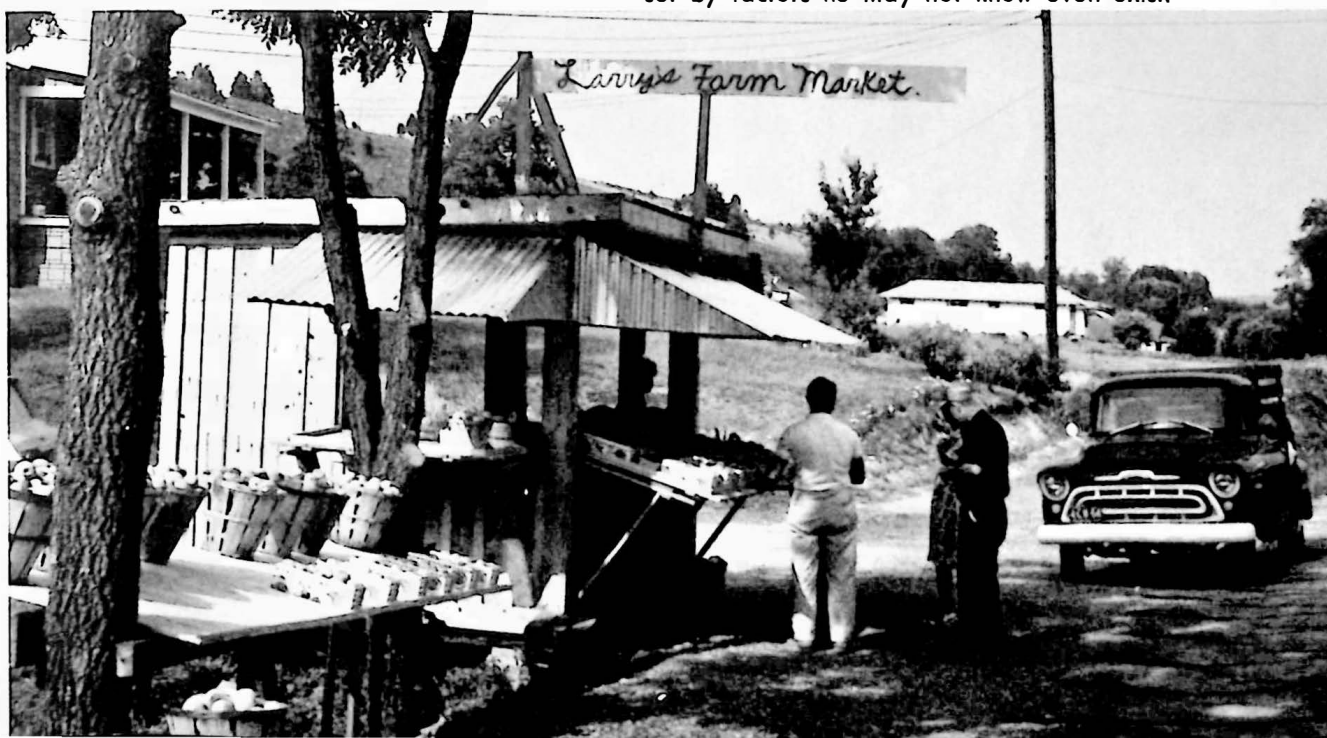
Both the buyers (consumers) and the sellers (producers) influence prices. In general, buyers will offer to buy more of a good if the price is low and less of a good if the price is high. Sellers, on the

other hand, will offer to sell more of a good if the price is high, and less of a good if the price is low.

The willingness of buyers to buy more at low prices and less at high prices can be shown in a *demand schedule*. A demand schedule shows the amounts of goods and services that customers are willing to buy at different prices. The willingness of sellers to sell more at high prices and less at low prices can be shown in a *supply schedule*. A supply schedule shows the amounts of goods and services that suppliers are willing to offer for sale at different prices.

Suppose that your tomatoes are just like those of thousands of other small farmers. You are selling your tomatoes in competition with them. Suppose, further, that there are a large number of competing small buyers. In this case the selling price of tomatoes would be the price at which all the

The prices charged by this farmer will be set by factors he may not know even exist.



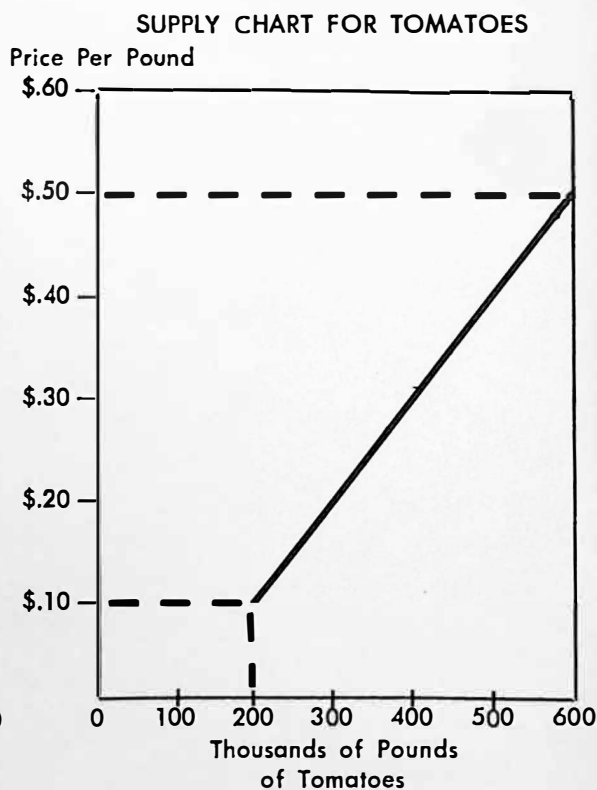
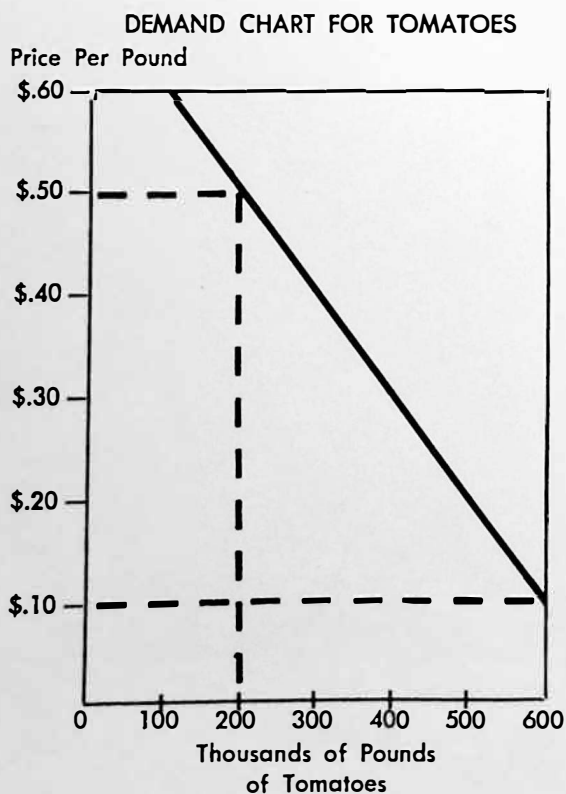
tomatoes for sale would be purchased. This would be the point at which the demand for tomatoes equaled the supply.

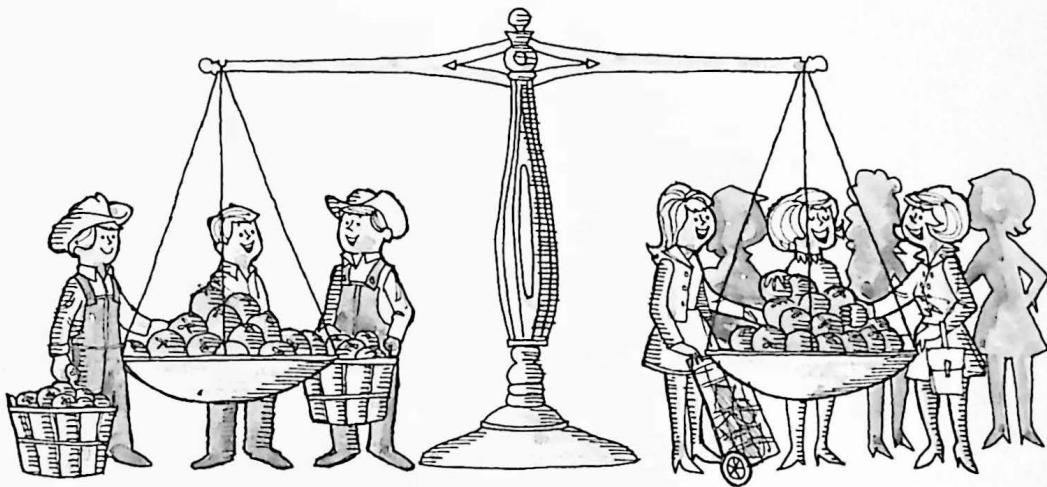
We can show how the price of tomatoes is determined by using three line graphs. One graph will show demand, another will show supply. The final graph you will construct to show the demand and supply inter-acting to determine the price.

The demand chart for tomatoes shows that at a price of \$.10 a pound, people will be willing to buy 600,000 pounds of tomatoes. At a price of \$.50 a pound, people will buy only 200,000 pounds of tomatoes. Remember that people will buy more pounds of

tomatoes if the price is low, but will buy less of them if the price is high. One reason for this is that when tomatoes are low in price, they are a better value than other foods. Some people will substitute tomatoes for other things. When tomatoes are high in price, many buyers will purchase some other foods instead.

The supply chart for tomatoes shows that at a price of \$.10 a pound suppliers will offer 200,000 pounds of tomatoes for sale. At a price of \$.50 a pound, suppliers will offer 600,000 pounds of tomatoes. Remember that suppliers will offer many pounds of tomatoes if the price is high, but very few of them if the price is low.





The balance of supply and demand governs the market price of a good or a service.

One reason for this is that high prices mean profitable production. You can pay all of your expenses and have a profit left over to enjoy. Many farmers will therefore produce and sell a large number of tomatoes when the price is high. Low prices, on the other hand, mean low profits or losses. Some farmers may not be able to pay all of their expenses and enjoy a profit. These farmers may decide not to produce any more tomatoes.

Now, see if you can make the final graph yourself. The final graph will tell you the price at which the demand for tomatoes will exactly equal the supply.

First, study the two graphs that you have already seen. Then take a blank piece of paper and a ruler, and construct a demand chart for tomatoes exactly like the one in the book. Be sure your graph information is correct.

Then, on the same graph, record all of the information from the *supply chart for tomatoes*. The point at which the demand line crosses the supply line is the point at which the demand for tomatoes will exactly equal the supply. If you have made your graph correctly, it will show that the price will be \$.30 per pound, and 400,000 pounds will be offered for sale.

The price of \$.30 will cause consumers to offer to buy 400,000 pounds of tomatoes. There is no other price on this graph where consumers will offer to buy and farmers will offer to sell exactly the same number of pounds of tomatoes. The *market price* of tomatoes will, therefore, be \$.30 for one pound. It is at this point that supply and demand will be in balance, and all of the goods offered for sale will be purchased.

## EXPLOITING THE UPGRADING URGE

Document 1: In this excerpt from his book, *The Status Seekers*, Vance Packard warns of some of the dangers of modern day mass advertising techniques.

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The role of advertising men in the emerging class picture is both curious and portentous. For solid business reasons, they are the ardent champions of an open-class society.

Advertisers have approximately eleven billions dollars at their disposal to spend each year on persuasive messages that, they hope, will influence our consuming behavior. In the past few years, they have been busily trying to discover the facts of class and status, and to apply their findings in shaping their sales appeals.

Some of their effort and study is directed toward making sales appeals more realistic in terms of the tastes and habits of the members of the particular socio-economic class they are trying to woo as their most likely customers (i.e. if it is beer you're selling, don't use a drawing-room setting. If it is swimming pools, don't use loud colors). Such realism would seem wholly commendable. If the average American family *must* be subjected to 1,518 sales messages a day — that's the estimate — let them be reasonable, realistic messages.

A great many advertisers, however, are not content with merely being realistic about class. They want to put some sizzle into their messages by stirring up our status consciousness. In fact, they sometimes playfully call themselves "merchants of discontent." They talk profoundly of the "upgrading urge" of people, and search for appeals that will tap that urge.

Many of the products they are trying to sell have, in the past, been confined to a "quality market." The products have been the luxuries of the upper classes. The game is to make them the necessities of all classes. This is done by dangling the products before non-upper-class people as status symbols of a higher class. By striving to buy the product — say, wall-to-wall carpeting on installment — the consumer is made to feel he is upgrading himself socially. Or the limited-success-class housewife can achieve that feeling by paying a few cents more each day for the brand of cigarette that is puffed so elegantly by the genuine Park Avenue matron in the cigarette advertisement.

Much of this exploiting of the "upgrading urge" is aimed at the workingman. As we have noted...the modern factory operative has very little opportunity to upgrade himself in his productive role in life. The advertisers, however, are continuously inviting him to upgrade himself, or herself, at least in his own mind, by adopting the consuming patterns of people in the higher classes.

Ely Chinoy, after studying...workers, makes the point that these people have "anonymous jobs and standardized wage rates." The only visible way left for them to advance in the world ... is by acquiring material possessions. And he adds: "With their wants constantly stimulated by high-powered advertising, they measure their success by what they are able to buy." A new car standing in front of one's home is seen as a symbol of advancement. New living room furniture, a washing machine, and television are seen as further confirmation that one is "getting ahead."

### THE POSITIVE SIDE OF ADVERTISING

Document 2: The well known economists Dr. Marshall Robinson, Dr. Herbert Morton, and Dr. James Calderwood point out some of the good things that advertising does. This excerpt is from their book *An Introduction to Economic Reasoning*.

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*Promotional activity* (advertising) is the most familiar form of competition. Advertising, branding of products, and the services of salesmen and dealers supplied with products, are well known to consumers today. It is sometimes claimed that these activities impose unnecessary costs on the public, but in general, promotional activities perform an important function. They bring information about products to the attention of consumers, and as a consequence the degree of competition may be heightened. If they expand markets, they may result in lower costs through mass production.

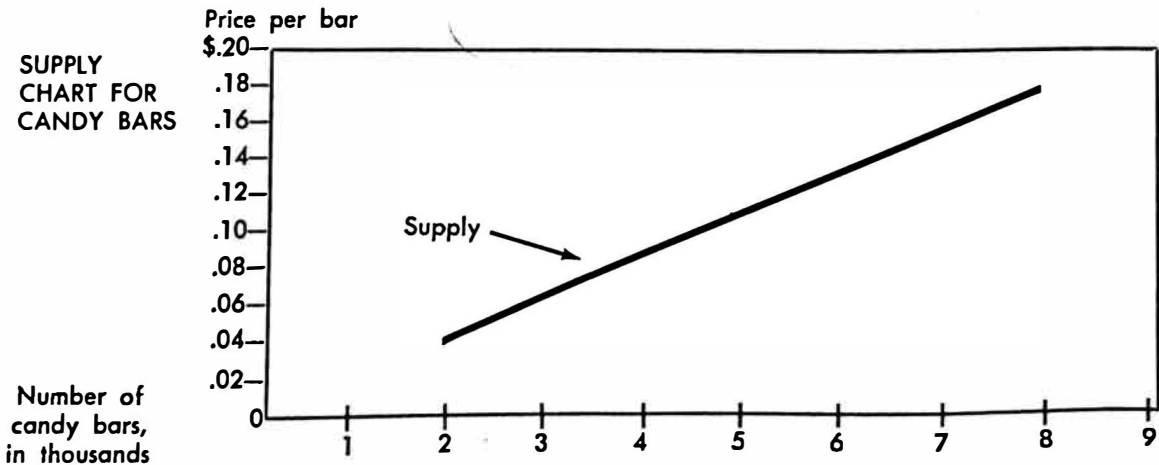
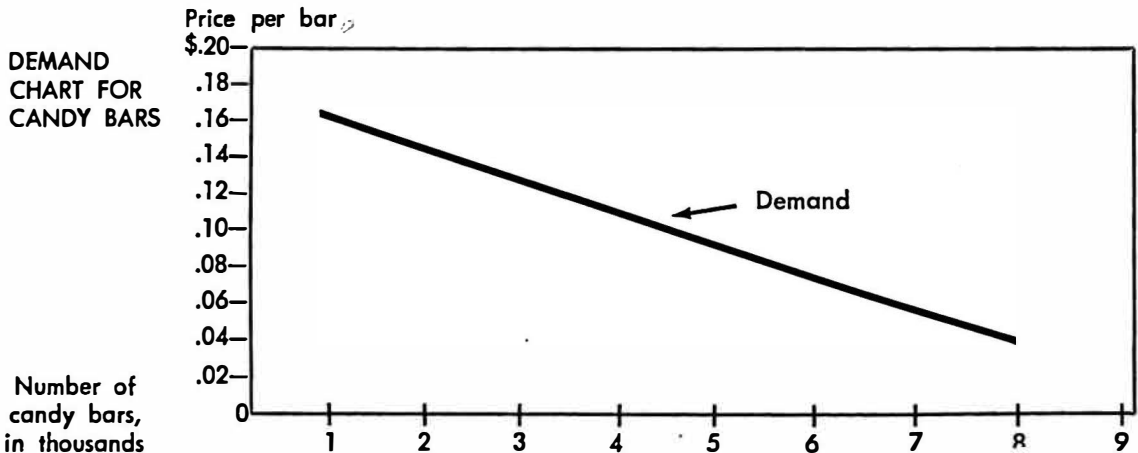
## Using Economic Methods

1. Reading a demand chart: using information you get from the demand chart for candy bars, answer the following questions.

- A. How many candy bars will customers offer to buy at a price of \$.15 per bar?
- B. How many candy bars will customers offer to buy at a price of \$.10 per bar?
- C. How many candy bars will customers offer to buy at a price of \$.05 per bar?

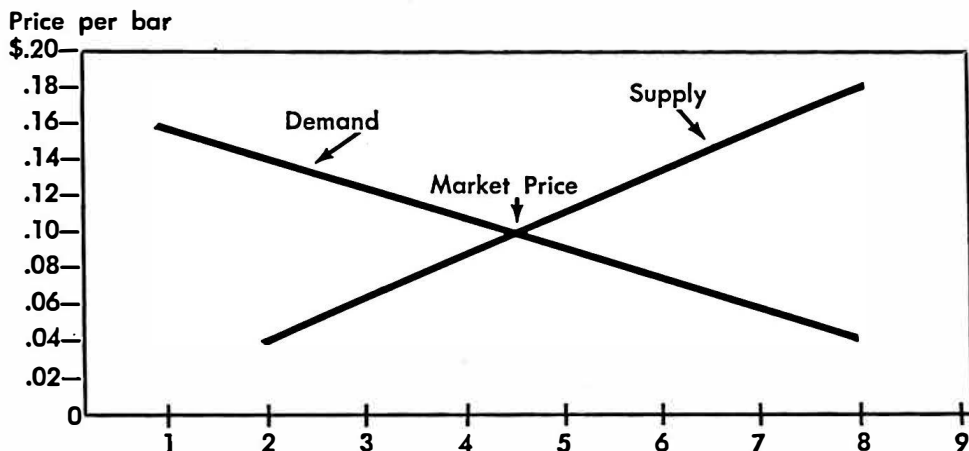
2. Reading a supply chart: using the information you get from the supply chart for candy bars, answer the following.

- A. How many candy bars will be offered for sale at a price of \$.15 per bar?
- B. How many candy bars will be offered for sale at a price of \$.10 per bar?
- C. How many candy bars will be offered for sale at a price of \$.05 per bar?



PRICE  
CHART FOR  
CANDY BARS

Number of  
candy bars,  
in thousands



3. Reading a price chart: using the information you get from the line graph showing you the price of candy bars, answer the following questions.

- A. What is the market price of candy bars?
- B. How many candy bars will be sold at this price?

person to convince the consumer to buy a certain good. 30

*brand name* /'brand 'nām/

An advertising term which identifies a product as that of a particular company. 30

*economy* /i-'kän-ə-mē/

The structure or system in any society which provides for means of production and methods of exchange of goods and services. 31

## Knowing Your Vocabulary

*necessary good*

/-'nes-ə-ser-ē 'gūd/

Good which people need and cannot easily do without. 27

*consumer demand*

/kən-'sü-mər di-'mand/

The desire for economic goods and services, and the ability to pay for them. 27

*commercial* /kə-'mər-shəl/

An advertising message on radio or television. 29

*endorsement* /in-'dör-smənt/

A recommendation by a famous

*land* /'land/

The physical earth, together with its natural resources. 32

*labor* /'lā-bər/

Human services used in production. The man-power which is necessary to first get, and then use, land's natural resources. 32

*capital* /'kap-ət-əl/

Goods, such as factory buildings, machinery, and unsold goods, produced to aid in the production of other goods. Usually described in terms of money value. 32

*management* /'man-ij-mənt/

The group of people who control and direct the activities of labor, land, and capital. 32

*market economy*

/'mār-kət i-'kän-ə-mē/

An economy in which goods and services are offered for sale to the highest bidder. 33

*law of supply and demand*

/lò əv sə-'plī ən(d) di-'mand/

An economic law which explains what goods and services will be produced and at what prices they will be sold. 33

*profit motive*

/'präf-ət 'mōt-iv/

The desire of a businessman to make money or profit. 34

*demand schedule*

/di-'mand 'skej-(.)ü(ə)l/

A line graph which shows the amounts of goods and services that consumers will buy at different prices. 35

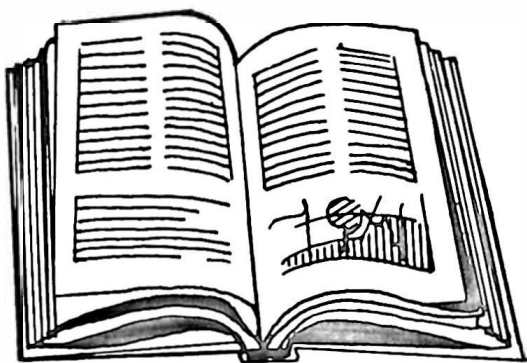
*supply schedule*

/sə-'plī 'skej-(.)ü(ə)l/

A line graph which shows the amounts of goods and services that producers will offer for sale at different prices. 35

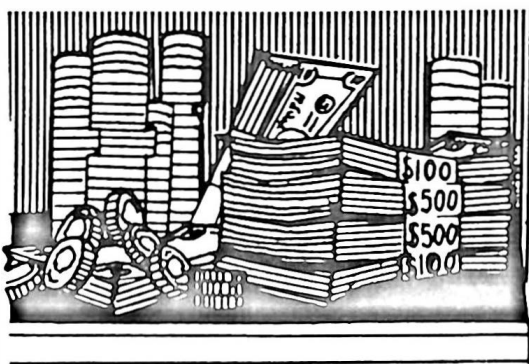
*market price* /'mār-kət 'prīs/

The price at which supply and demand are in balance, and at which all of the goods offered for sale will be purchased. 37



## Reading the Text

1. What economic tool is used to explain economic demand?
2. How does advertising affect consumer decisions?
3. Why are consumers willing to buy a larger amount of a good at a lower price?
4. How is the economic method used by the consumer when he makes his purchases?



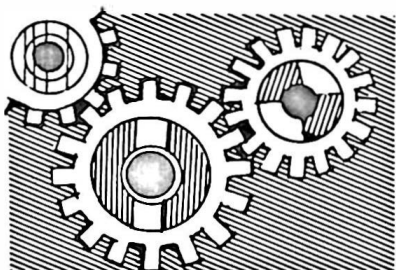
## Identifying Names and Terms

Thorstein Veblen

Madison Avenue

Conspicuous consumption

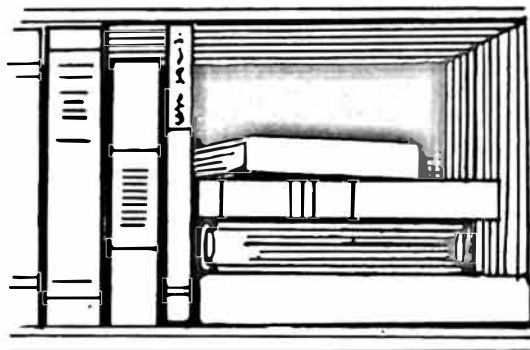
Factors of production



## Debating and Discussing Ideas

1. Study the two documents at the end of the chapter. Do the two writers agree or disagree with each other about the effects of advertising?
2. What are the effects of advertising according to Packard? What are the effects of advertising according to Robinson? Do you agree or disagree with the ideas of the two writers? Which writer do you agree with? Why?
3. Several times in the chapter you were asked to make lists of some of the reasons why you may have purchased a good. Read your lists and then answer the following questions:
  - A. Were most of your purchases your own decisions, or were most of them affected by advertising?
  - B. Did you buy most of your goods because you needed them, or because you desired them?
  - C. Were most of your purchases the results of one, or of many different reasons?

4. We live in a market economy. What is produced and the price for which it will be sold is affected by the laws of supply and demand. What do you think are the advantages and the disadvantages of this type of economy?



## Reading Other Sources

Feinberg, D. *Consumer Economics*. New York: Holt, Rinehart and Winston, 1964.

Heckman, H.W. *The Economics of American Living*. Chicago: Rand McNally, 1963.

Jones, Peter d'A. *The Consumer Society*. Baltimore: Penguin Books, 1965.

Kreisman, L.T. *The Consumer In Society*. New York: Odyssey Press, 1964.

Packard, V. *The Hidden Persuaders: What The Consumer Should Know About Motivational Research*. New York: David McKay, 1957.

### 3. Consumer Budgeting

*The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers....*

Subchapter I—Consumer Credit Disclosure,  
Title 15, 1601 U.S. Code Annotated



What is a budget?

Man is a thinking animal. To think is to plan for the future. Man sets goals and develops plans to reach these goals. If the goals are practical they can be reached. If they are not, they probably never will be reached.

Some people do not spend money wisely. They purchase goods which they cannot afford. They buy things that they do not need. After these unwise purchases, they have no money left to buy what they do need. When money is wasted, man is not acting economically.

The economic man, or thinking man, prepares a spending plan. The plan should relate income to *expenditures*, or money spent. It should balance what you make with what you spend. This plan for spending is called a *budget*.

As you have seen, human wants are unlimited. But economic resources are limited. Most people will never have enough money to buy all the things that they want. Without planning, many people would simply buy the first thing that they liked. They would not buy necessary things first. This is how a budget helps. A budget helps you choose among the alternatives. It helps you spend what you have carefully. It is a study of how you can live within your income.

Not everyone can drive a new, high-priced car, live in a big house, spend all summer on vacation, or have all of the clothes

that he or she wants. Why? Their income is limited. Their income does not permit such luxuries. Most people must settle for less. They must choose wisely from among the things that they can afford to buy. They must try to get the most for the money that they have. This goal can only be reached with planning. Through careful budgeting, many things will be possible.

How can you prepare a budget?

The first step in preparing a budget is to consider your needs. A budget should be made to fit each individual person. The needs of the junior high school student are different from those of the college student. The needs of the college student are different from those of the head of the family. Any budget should consider all possible income as well as all your possible expenses.

The use of a budget will help you plan wisely what to do with the money that you have. An important way that many students get their money is through an *allowance*. An allowance is a sum of money given to a student on a regular basis to help him pay for his expenses. For the junior high or high school student, an allowance may be paid monthly. This will give him the chance to plan over a long period.

The amount of the allowance should be large enough to cover normal expenses such as transportation, books, and lunches. A

weekly budget for a junior high school student might be drawn up as the budget shown below. The allowance should be large enough that some money will be left over after all normal expenses have been paid. The extra money, or *surplus*, will give the student a chance to plan the spending of his money. He will have to decide how to spend the extra money.

If the student does not have enough money to cover his expenses, he will have a *deficit*. His expenses will have to be cut, or he might add to his allowance by earning extra money at part-time jobs.

Sometimes the allowance is lowered as the student earns more and more money of his own. The ones who wish to become inde-

pendent and pay for their personal expenses will give up their allowance completely. Parents may then put the allowance into an educational fund. Perhaps they will let the student himself set the money aside for his future plans.

When you have money of your own to manage, you should set up a spending plan. This plan should compare your planned spending (your budget) with what you actually spend. The plan can be simple. A plan that shows how your money will be spent is all that you will need. This should help you develop an interest in money management. It will give you some experience in budgeting. It will help you spend what money resources you have to satisfy your needs and wants.

The use of a budget is important to everyone who cares how and why his money is spent. It means getting the most use from your money.

**TABLE 1. A BUDGET FOR A WEEK FOR THE JUNIOR HIGH STUDENT**

Income	Amount
Allowance	\$1.50
After school errands	.75
Chores	.75
Odd jobs	.50
<b>Total Income</b>	<b>\$3.50</b>

<b>SURPLUS OR DEFICIT</b> (Subtract total expenses from total income)	<b>.15</b> <b>SURPLUS</b>
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Regular Expenses	Amount
Lunch	\$1.25
Club dues	.10
Miscellaneous	.25
<b>Total Regular Expense</b>	<b>\$1.60</b>
Occasional Expenses	Amount
Recreation	\$.50
Newspapers, books, magazines	.25
Personal items	.50
Miscellaneous	.50
<b>Total Occasional Expenses</b>	<b>\$1.75</b>
<b>TOTAL EXPENSES</b>	<b>\$3.35</b>

Prepare a spending plan for yourself. Compare your planned and your actual expenses. The chart below can be used as a model.

Some expenses occur regularly. These expenses should be listed in the budget under Regular Expenses. Some expenses occur less often and should be listed in the budget column under Occasional Expenses. The total expenses should not be greater than the amount of money that you can spend. The amounts in the Budget Column are for spending.

At the end of the week write what you spent in the column headed Actual Expenses. You can then compare the amount of money you spent with the amount you planned to spend. At first it

may be difficult to have your planned expenses equal your actual expenses. But every week you will gain in budgeting experience. Every week your planning will become easier. For now, talk with several of your friends. Plan budgets for the next school week. See how many of you will be able to keep within your budgets.

#### How can you buy goods more effectively?

Your forefathers would have told you to get the most for your money. What did they mean? Certainly they did not mean that you should purchase the greatest possible number of goods. "Getting the most" means more than getting a lot.

**TABLE 2. SPENDING PLAN FOR A MONTH**

Comparison of Budgeted and Actual Expenses Income: \$3.50 per week.								
	First Week		Second Week		Third Week		Fourth Week	
Regular Expenses	Budg. Exp.	Act. Exp.	Budg. Exp.	Act. Exp.	Budg. Exp.	Act. Exp.	Budg. Exp.	Act. Exp.
Lunch	1.25	1.25	1.25	1.40	1.25	1.40	1.25	1.25
Club dues	.10	.10	.10	.10	.10	.10	.10	.10
Miscellaneous	.25	.10	.25	.25	.25	.30	.25	.30
Occasional Expenses								
Recreation	.50	.60	.50	.35	.50	.40	.50	.45
Newspapers, books	.25	.25	.25	.00	.25	.30	.25	.35
Cosmetics, personal items	.50	.50	.50	.00	.50	.60	.50	.00
Miscellaneous	.50	.25	.50	.50	.50	.50	.50	.45
<b>TOTAL EXPENSES</b>	<b>3.35</b>	<b>3.05</b>	<b>3.35</b>	<b>2.60</b>	<b>3.35</b>	<b>3.60</b>	<b>3.35</b>	<b>2.90</b>
Surplus	.15	.45	.15	.90	.15		.15	.60
Deficit						.10		
<b>SURPLUS PER MONTH</b> Anticipated: \$.60      Actual: \$1.85								



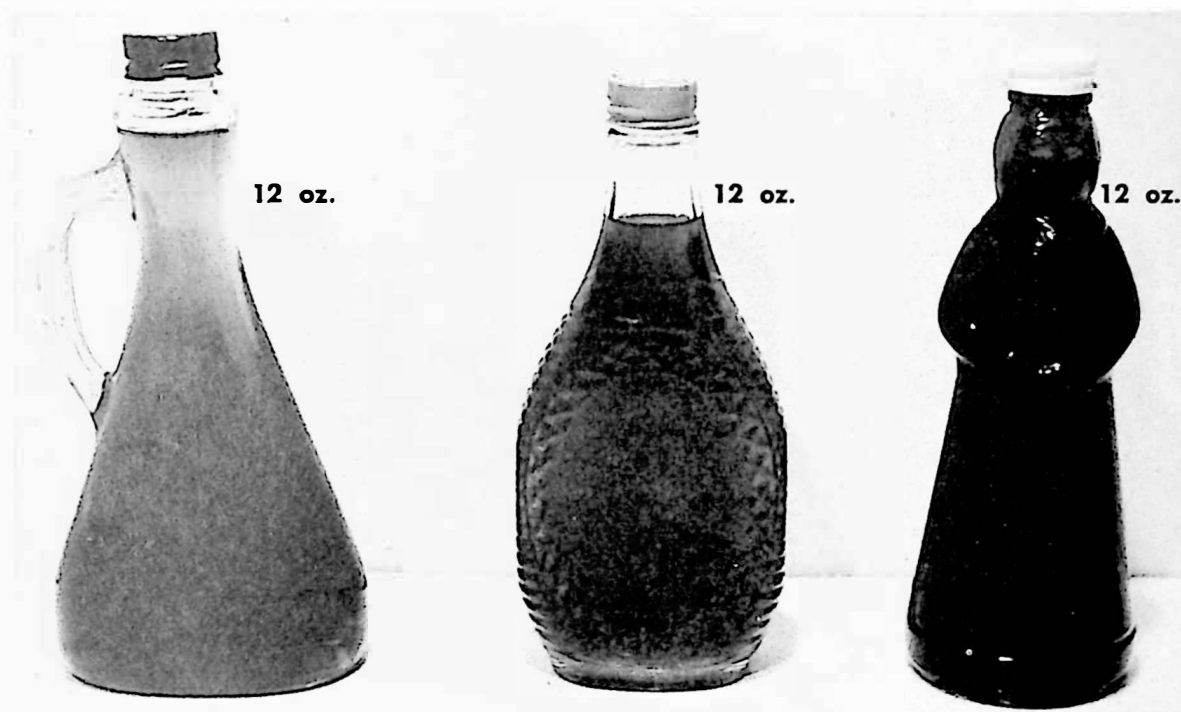
At one time the grocer made our economic decisions easier by using his knowledge to help us choose the best bargains.

It means that you must balance your purchases. You must try to get variety and quality in your purchases. Simple quantity is not enough. Above all it means buying intelligently. To buy intelligently you must compare quantity, quality, and prices among the many competing goods. This is not easy to do.

See what has happened to the grocery store. Thirty years ago the consumer did not personally choose purchases from a supermarket shelf or freezer. He read his shopping list to a grocer who took down the goods from his

shelves and put them in a carton. The grocer knew the comparative quantities, qualities, and prices of the different goods. He could tell his customer the price per pound of different goods.

The convenience of cart-shopping at the supermarket led to the replacement of the grocer. Now the shopper filled his own orders. No one helped him select his goods. He had to do it alone. At this point the consumer became confused. The already-packaged groceries came in many kinds of boxes, cans, cartons, bottles, and tubes. To make matters worse,



Odd-sized and odd-shaped packaging has made consumer decisions more difficult.

package sizes became odd-sized. Instead of the usual pint, quart, gallon, or pound, the consumer was faced with labels like "1 lb. 6 oz. net weight." Comparisons between goods became difficult or impossible. Many times he was attracted to a package by its size, shape, or color. He paid little attention to the *net*, or real, contents of the package. Often the consumer did not know that the net weight or net volume shown on the package was the real weight or amount of the product inside.

As time went on, it became more and more difficult for the consumer to make wise purchases. So, to help the consumer, the federal government passed the Fair Packaging and Labeling Act.

#### What has been the effect of the Fair Packaging and Labeling Act?

On November 3, 1966 the Fair Packaging and Labeling Act became law. The aim of the act was to help the consumer make price comparisons between competing goods. One section of the act stated that the net, or real, contents of every type of package had to be clearly marked.

Many people hoped that the new law would make it easier to make intelligent shopping decisions. The act has not done so. Net contents and prices are more clearly marked on packages today. However, consumers still are not always able to make the best buy for the money. Clearness in labeling has been offset by two things.

First, most people simply do not know how to figure the price per pound from the price and net weight. Second, there has been a great increase in the variety of brands of products for sale. It would take a lot of time to figure the price per pound or ounce for each one as you shop. This means that even when consumers know how to convert the different net amounts and prices for comparison, they may not have the time to do it.

Many consumers are still not educated to the need of looking for the net contents of the goods that they are buying. They are fooled by the size of the package as well as by descriptions on the package. These sizes and descriptions have no real meaning. For example, what is a standard amount for "king size," "jumbo," "large,"

"medium," "regular," and "small"? Since "large" is not the same size in net contents for different brands of goods, how can you compare the cost of the "large" sizes of two different brands of goods? The consumer should never take it for granted that the "large" size is always the best buy.

One example of this fact appeared in an article in the *Wall Street Journal*. The article makes the point that general size descriptions like "medium," "large," and "giant," have no real meaning for consumers.

The only important thing is to ask, "How much product is there in each package"? In this case, there were 3.25 oz. of tooth paste in each tube. The "giant" size was exactly the same as the "medium" and "large" size.

When you purchase a loaf of bread, you should ask the question, "What is a loaf?" A trip to the bread department of any store will show you that there is no standard size for a loaf. Loaves come in all sizes and shapes. The only way to compare the prices of similar products is to compare weights.

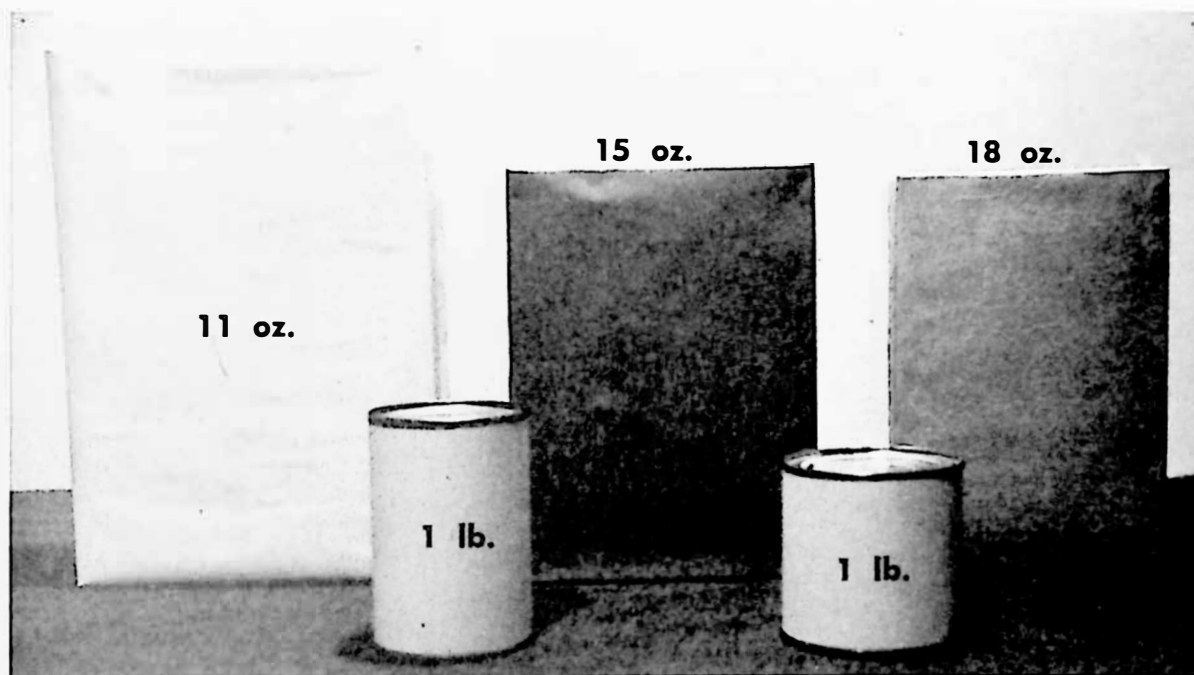
A recent trip to the grocery store revealed that we can be fooled by package size. Among three competing breakfast cereals, the smallest box size contained the greatest net weight of cereal. The largest box size contained the smallest net weight. A customer looking only at the size, without studying how much cereal was in

By Ronald G. Shafer  
Staff Reporter of the *Wall Street Journal*

*Washington* — Question for consumers: Which contains more toothpaste — a "medium" tube of Colgate, a "large" size of Crest or a "giant" tube of Pepsodent?

Answer: They're all the same. Each tube weighs 3.25 ounces.

Source: *Wall Street Journal*,  
Nov. 6, 1969.



Which packages contain the most product?  
Don't be so sure that the largest  
packages contain the most.

each box, would choose the largest box. You must compare similar products as well as the sizes and weights of the packages.

#### What is credit?

Sometimes it may become necessary for you to spend more money than you have. You may have to purchase something in an emergency while you are short of cash. You may want a good so much that you are not willing to wait until you have saved the cash. The good may be so expensive that you could never save enough money.

In all of these cases, the consumer may purchase goods without cash through the use of *credit*. When a consumer is given credit, he is given a loan by the *creditor*. The creditor is the businessman who gives credit.

Credit may be a loan in the form of straight cash. It may be a loan in the form of cash advanced from a businessman so that the consumer can then buy a good or a service from him. The consumer who borrows is called the *debtor*. The money that he owes is called a *debt*.

When you buy a television set from the Corner Store on credit, what actually happens is this. Even though he does not actually give you money, the owner of the Corner Store is advancing you the cash to purchase the television set from him. He, the creditor, is trusting you, the debtor, to pay back the money at a future date.

For this service the creditor charges you an additional amount of money, called *interest*, for the use of his money. As you will see

in Chapter 5, whenever a loan is part of any economic exchange, interest will have to be paid by the debtor to the creditor. While you are paying off the amount of his advance, he trusts you with the use of the goods that you bought. Credit, as you can see, is a form of trust.

**What is the importance of the charge and the credit card?**

As you have already learned, credit allows purchases now while putting off payment to the future. There are many different kinds of consumer credit. Two pop-

ular forms of credit are the *charge account* and the *credit card*.

The charge account is an account opened with a store. Through the charge account the store sells merchandise to the consumer, who then pays for the merchandise at a later time. To open a charge account, the consumer finds he has to fill out forms with information about himself. These forms are then studied and checked. If the store's credit department feels that the consumer can be trusted to pay his bills, he is given a charge account at the store. The consumer can then buy goods at any time at that store and charge them to his account.

Usually the consumer who has a charge account is given a *charge plate*. A charge plate is a card that identifies the consumer when he wants to use his charge account. The plate shows his name, his home address, and his account number. Every store that has charge accounts has its own design for its charge plates. The charge plate of one store may not be used to make purchases at another store.

The credit card differs from the charge plate in that the credit card may be used for purchases from many different stores and businesses. The consumer can use the same card to buy clothes, pay for his lunch at a restaurant, purchase a ticket for an airplane flight, and pay his motel bill.



The careful use of credit will permit the consumer to enjoy goods and services now and pay for them at a later date.

With a credit card the consumer has only one bill to settle. He charges goods and services at many different businesses and stores. The businesses and stores bill the credit card company. The credit card company then bills the consumer for all of his purchases. The consumer pays only the credit card company. He owes only the credit card company.

Credit cards are a convenience. They do away with the need for carrying large amounts of money or many individual charge plates in your wallet or purse. They may help you buy goods and services in an emergency when you may be short of available cash. Credit cards cannot yet be used everywhere. However, more and more businesses are accepting them.

What are the dangers of the use of credit cards and charge plates?

There are many dangers to using credit cards and charge plates. You must always be very careful with them. The first and greatest danger is charging too much. It is easy to charge more than you can afford to pay. This is because you do not actually see your money being spent. It seems almost as if you were getting goods and services without having to pay for them. You may forget when you buy goods that you will have to pay for the goods at some future time. You enjoy the goods and forget about the payment for them. Further, it is easy to make many

small purchases with charge cards. These many small purchases may not seem like much at the time of their purchase. But they may add up to more than you will be able to pay when your total credit bill is presented to you.

Two good rules to remember are these:

- 1) Always keep track of the total amount of all of your credit purchases.
- 2) Never allow total charges to amount to more than you could afford to pay with one week's income.

A second danger may result from the loss or theft of your cards. You must always be careful to guard them. If you have credit cards or charge plates and they are stolen, you must let the stores and credit card companies know immediately. Otherwise you may have to pay for the purchases made by someone else using your lost or stolen cards.

Credit is given to people who pay their bills promptly on the *due dates*. The due date of the bill is the date on which the debt or bill must be paid. People who pay their bills when they are due are given a high *credit rating*. The right to buy on credit depends upon your credit rating. If you are careful and keep a good credit rating, you will be able to enjoy all of the conveniences of credit buying. If not, you may not be able to get credit even if you need it in an emergency.

What is the nature of installment credit?

Charge credit is not the only form of consumer credit with which you should be familiar. An even more common form of consumer credit is *installment credit*. High priced consumer goods, such as television sets, automobiles, refrigerators, and furniture are often paid for in a number of payments, or *installments*.

The consumer must sign an installment *contract* when he buys a good on the installment plan. A contract is a legal agreement between two or more persons. It

explains things that each person promises to do in the future.

The installment contract gives the consumer the use of goods, but he does not own them. This is because the consumer pays little or no cash at the time of his purchase. Instead he gives his promise to pay at some future date. He will not have to pay the whole amount that he owes at one time. He will pay off this amount in installments over a certain period of time. When he has paid off the amount that he owes, the ownership of the goods will be given to him, the consumer.

#### NOTE AND SECURITY AGREEMENT

No. \_\_\_\_\_, Illinois \_\_\_\_\_, 19\_\_\_\_ Amount \$ \_\_\_\_\_  
FOR VALUE RECEIVED, the undersigned Debtors, jointly and severally, promise to pay to the order of \_\_\_\_\_ (hereinafter called "Bank") at its \_\_\_\_\_, Illinois, the sum of \_\_\_\_\_ in \_\_\_\_\_ installments of \$ \_\_\_\_\_ each and a final installment of \$ \_\_\_\_\_, beginning on \_\_\_\_\_, 19\_\_\_\_ and continuing on the same day of each successive month thereafter until fully paid.

Default in making payment of any installment hereof or the occurrence of any event of default under the provisions hereof shall, at the option of Bank holder hereof, and without notice or demand, render the entire unpaid balance of this note and accrued charges, at once due and payable. Demand, present payment and notice of dishonor are hereby waived by the Debtor and every endorser or guarantor hereof. All endorsers and guarantors consent that the time of payment may be extended or renewal notes taken by holder without notice to them and that such extension or renewal shall not discharge their liability. Debtor agrees to pay all costs and expenses of collection including reasonable attorneys' fees and court costs.

#### DISCLOSURE STATEMENT

##### SECURITY INTEREST

This loan is secured by a security interest in the property hereinafter described. Bank's security interest secures future or other indebtedness and will cover after-acquired property.

This note contains a confession of judgment clause and grants the Bank the right of set-off or lien on any deposit or sums now or hereafter owed by Bank to Debtor.

##### DELINQUENCY CHARGE

Delinquency charge on each installment in default for a period of not less than 10 days is 5% of the installment or \$5, whichever is less. In addition, Debtor is obligated to pay costs and disbursements, including reasonable attorneys' fees, incurred by Bank in legal proceedings to collect the loan or to realize on the security after default.

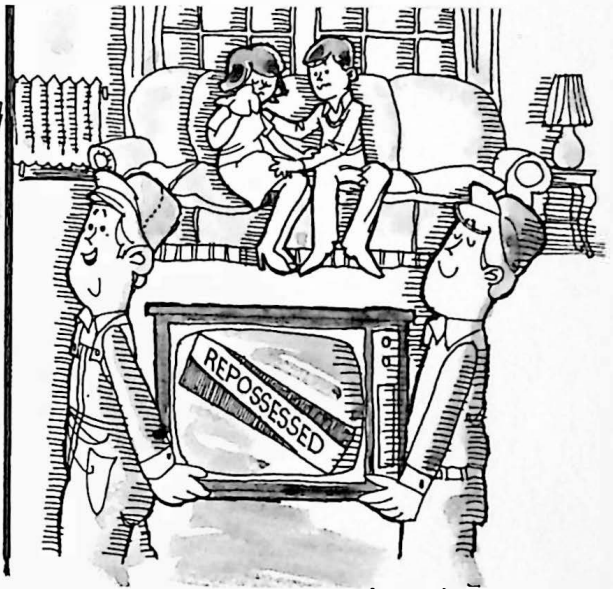
##### RIGHT OF PREPAYMENT

Debtor has the right to prepay the loan in full on any installment date and to receive a rebate of unearned interest computed on the Rule of 78th's. Prepayment in full will also reduce the insurance charge (if any) for the loan.

1. Proceeds . . . . . \$ \_\_\_\_\_
2. Other Charges (if any)  
Official Fees . . . . . \$ \_\_\_\_\_  
Credit Life Insurance Premium . . . . . \$ \_\_\_\_\_  
Credit Disability Insurance Premium . . . . . \$ \_\_\_\_\_  
Property Insurance Premium . . . . . \$ \_\_\_\_\_
3. Amount Financed (1 + 2) . . . . . \$ \_\_\_\_\_
4. FINANCE CHARGE, consists of: . . . . . \$ \_\_\_\_\_  
Service Charge . . . . . \$ \_\_\_\_\_  
Interest . . . . . \$ \_\_\_\_\_  
Accrues from date of disbursement
5. Total of Payments . . . . . \$ \_\_\_\_\_  
ANNUAL PERCENTAGE RATE . . . . .  
Total of Payments is payable in \_\_\_\_\_ monthly installments of \$ \_\_\_\_\_ each and a final installment of \$ \_\_\_\_\_ beginning on \_\_\_\_\_, 19\_\_\_\_ and continuing on the same day of each successive month thereafter until the note is paid in full.



Buy now. . .



. . .and pay later.

Like any contract, the installment contract is *legally binding*. This means that once the consumer has signed the contract, the law requires that he live up to the contract's terms. For this reason the consumer must be sure that he reads and fully understands the contract before he signs it. Now let us see what buying on installment will cost the consumer in dollars and cents.

**What are the terms of an installment contract?**

Your parents have decided that they would like to buy a color television set. They will buy it on the installment plan. The price of the set is five hundred dollars.

Before signing the contract, your parents read it over very carefully. They are very interested in the terms, or conditions, of their new contract.

In the first place they see that they will have to make a *down payment* for the television set. A down payment is a portion of the purchase price of the set. Many companies require a down payment for installment purchases. The down payment must be made in cash at the time of the purchase. The down payment is the security that your parents will complete all of the payments for the television set. If they do not, they will lose both their down payment and the set.

If an installment buyer does not make his payments, the store will then *repossess* the merchandise. When a company repossesses goods, it takes them back from the buyer. The company will also keep part, and sometimes all, of the money that has already been paid for the goods. This includes the down payment.

Next, your parents will want to find out how many installment payments they will have to make. Most installment contracts let you choose the number of payments you must make to pay off what you owe. The length of time that it will take you to pay is based on the number of payments you choose to make. Installment payments are usually made once a month. Monthly payments for the average installment purchase will last from one to three years.

Part of the monthly payment will be put toward the purchase price of the merchandise. Part of the monthly payment will pay for the interest charge for your installment purchase.

The interest charged for an installment purchase is called the *finance charge*. The amount of the finance charge depends upon two things:

- 1) The percentage charged for interest;
- 2) The length of time you take to pay off what you owe.

Most installment contracts have a finance charge of at least 12 percent a year. Many have finance charges that are much, much higher. The amount of interest, or finance charge, of an installment purchase can push the price of the good much higher than what you thought it would be.

Your parents then see that this installment contract requires that the debtor have a *credit-life insurance* policy. This insurance

pays the creditor in the event of death of the purchaser. The family would not have to continue to make payments for the goods, and the goods would not be repossessed. The average charge for this insurance is about one dollar per year for every one hundred dollars you owe. Not all installment contracts require a credit-life insurance policy. The charge made for the credit-life insurance will also add to the total cost of the installment purchase.

Finally, your parents look in the contract for the *penalty clause*. The penalty clause explains what will happen if you do not make your payments on time. The penalty for a late payment in this contract is a charge of 5 percent of the payment. This means that if your monthly payment is \$21.00 and you are late with your payment, your penalty, or *late charge*, will be 5 percent of \$21.00. Your late charge will be \$1.05. Your total payment must be \$22.05. All installment contracts have one or more penalty clauses.

Most of the time these penalty clauses are fair. They are put in the contract to protect the creditor. But there are some penalty clauses that are not fair and are put into the contract to punish the debtor. This is why your parents are very careful to read all of the small or "fine print" in their contract. They know that there are many things they must guard against in an installment contract.

You should always be able to answer all of the following questions *before* you sign any installment contract.

1. What is the total price that you will have to pay?
2. How much is the down payment?
3. How much is the regular installment payment?
4. Are all of the payments equal in size?
5. When is each payment due?
6. To whom should the payments be made?
7. What are the penalties for late payment?
8. Are there insurance or other additional costs?
9. How much, in dollars and cents, are the actual finance charges?
10. When will you receive the merchandise that you are buying with this installment contract?
11. Do you understand the complete contract, including the "fine print"?

What things must you guard against in an installment contract?

Some installment contracts are called *balloon contracts*. Balloon contracts are those which have a very large final payment. The final payment may be so large that you might have to borrow money to pay it. If you cannot make this final payment, the company will repossess the goods. You will also lose all of the money that you have already paid.

An installment contract may contain an *acceleration clause*. An acceleration clause states that if one payment is late or missed, all of the remaining payments must be paid immediately. If you cannot pay all of the payments, the goods can be repossessed without notice.

If you are late with your payments, some installment contracts can punish you with a *wage assignment* clause. This clause

can result in a court order called a *garnishment*. A garnishment will allow the company to collect part of your wages right from your employer, until your installment debt is paid.

Sometimes an installment contract may contain hidden finance charges. Whenever a company advertises "no down payment" or "no finance charges" for its installment purchases, you should be on your guard for hidden finance charges.

For example, a company might advertise, "Buy our wrist watches on the installment plan...no interest or finance charges...price, only \$24.00." The customer is allowed to pay for a watch over a period of twelve months. At first it seems that there are no finance charges, but there are. The same watch may be bought in any store for only \$20.00. The higher price includes a \$4.00 finance charge.

Now that your parents have carefully studied their installment contract, they may go ahead and sign it. Your parents make a down payment of one hundred dollars. They will pay the remaining four hundred dollars in installments. Their finance charge will be 12 percent per year. They will have credit-life insurance. The table shows you what they will have to pay for their five hundred dollar television set. The table shows you what they will have to pay for one, two, or three years.

Which of the three plans do you think that they should choose? There are several things which a good installment plan should do. It should let them enjoy the use of goods before they can pay for them. It should have a minimum total finance charge. The monthly payments should be large enough to pay off the purchase as quickly as possible. The monthly payments should be small enough so they do not take up too much of their monthly income. Which plan best meets these requirements? Why?

**TABLE 3. MAKING AN INSTALLMENT PURCHASE**

	12 mos.	24 mos.	36 mos.
Original cost of the television set	\$500.00	\$500.00	\$500.00
Minus down payment	\$100.00	\$100.00	\$100.00
To be paid in installments	\$400.00	\$400.00	\$400.00
Plus finance charge at 12% per year	\$48.00	\$96.00	\$144.00
Plus credit—life insurance at \$1.00 per \$100.00 owed per year.	\$4.00	\$8.00	\$12.00
Total to be paid in installments	\$452.00	\$504.00	\$556.00
Add what you have already paid in your down payment	\$100.00	\$100.00	\$100.00
Total cost of the television set	\$552.00	\$604.00	\$656.00
Monthly payments	\$37.66	\$21.00	\$15.44

Your parents' total income per month is \$500.00. After paying all of their necessary expenses (rent, food, clothing) they have \$95.00 per month to spare. Their installment payments will have to be subtracted from this \$95.00. Remember that part of the \$95.00 will be spent for entertainment and emergencies. Some of it should be saved. Keeping all this in mind, which of the three installment plans will be best for your parents?

### What is the meaning of the phrase "Truth In Lending"?

As you can see from what we have said, an installment purchase can be a very risky business. Great care should always be taken before signing any installment contract. You, as a consumer, have been aided by the passage of the Consumer Credit Protection Act by the federal government. Title I of this act is called the Truth In Lending clause. Understanding this clause is very important to anyone who is planning to make an installment purchase.

The purpose of this act is

"to assure that every customer who has need for consumer credit is given meaningful information with respect to the cost of that credit which, in most cases, must be expressed in the dollar amount of the finance charge, and as an annual percentage rate computed on the unpaid balance of the amount financed."

Basically, this means that the company from which you are making your installment purchase must tell you exactly what that purchase is going to cost you. They must show you, in dollars and cents, the exact amount of interest you will have to pay for the installment purchase. They must show you what the full percentage amount of the interest they are charging you is going to be.

The act also requires that all other important credit information be given you. This makes it possible for you to compare their

COST OF A \$100.00 LOAN

	3 months	6 months	9 months	1 year
1%	.25¢	.50¢	.75¢	\$ 1.00
2%	.50¢	1.00	1.50	2.00
3%	.75¢	1.50	2.25	3.00
4%	1.00	2.00	3.00	4.00
5%	1.25	2.50	3.75	5.00
6%	1.50	3.00	4.50	6.00
7%	1.75	3.50	5.25	7.00
8%	2.00	4.00	6.00	8.00
9%	2.25	4.50	6.75	9.00
10%	2.50	5.00	7.50	10.00

credit charges with the credit charges of other companies. You will then have the information you need to make the wisest and most economical choice as to where and from whom you should make your installment purchase. You should insist on this information whenever you are about to make an installment purchase. It will help you stay away from a serious economic trap. This is the trouble that results from using credit without understanding it.

We have tried in this chapter to point out to you, the consumer, some of the tools that you can use to increase your buying power. We have also shown you some of the things that the consumer should be on his guard against when dealing in the economic society. Just remember that buying without planning can result in financial trouble. Careful planning will help you fully enjoy your buying power and still keep you out of financial trouble.

## HOW FRESH IS THE FOOD YOU BUY?

Document 1: Do you think it is important that you know the "fresh date" of the food that you buy? Can you think of any cases that you have heard of where the sale of spoiled food caused sickness or even death? This *Associated Press* dispatch of July, 1970 takes up these questions.

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The Government soon will begin a preliminary study of whether packaged foods—such as bologna, sausage and margarine—should be dated like camera film to prevent over-age products from being sold.

Although manufacturers oppose such a requirement, their products already carry coded dates that tell the grocer, but not the shopper, if the food is too old... The companies generally oppose any open dating of their products. They argue that their code dates are meant primarily as a management tool to assure that older items are sold first. And they say, if consumers could read uncoded dates they would buy the fresher products, leaving the older ones and eventually causing increased waste and cost to the consumer.

Some, such as spaghetti makers, say their products don't spoil.

Others, such as frozen-food processors, say proper handling is far more important than age in determining the wholesomeness of the food. They say the foods would last indefinitely if kept frozen hard, but will suffer immediately if allowed to thaw. Advocates of uncoded dating say the consumer has a right to know how fresh is the food he buys.

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## LEGISLATORS CALL FOR PROTECTION FOR CONSUMERS AGAINST REPOSSESSION PRACTICES

Document 2: The dangers of careless installment buying are clearly pointed out in this article from the July 21, 1970 edition of the *Wall Street Journal*.

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The other night Rick Civerolo and Jan Fisher stole a couple of cars...It was all in a night's work—and perfectly legal—because Mr. Civerolo and his helper are auto repossessionors, or "repo men." Mr. Civerolo's clients—banks, finance companies and auto dealers—pay him \$40 a car, plus expenses, to snatch anywhere from 60 to 110 cars a month from under the noses of sleeping owners who have fallen behind in their payments...

Repo men like Mr. Civerolo who prowl the streets at night are often seen as the "bad guys" in the bad debt drama, but legal critics are beginning to point

an accusing finger at what they claim is the real culprit: State laws that, with-our exception, permit—and some say encourage—creditors to take a car away from a defaulting buyer, sell it off quickly below its fair market value and then sock the hapless buyer for the rest of his debt...

Philip Shuchman, law professor at the University of Connecticut, charges that present laws are biased heavily in favor of the creditor and provide "...means for lawfully fleecing" the consumer...Prof. Shuchman cites an example of a man who bought a car for \$2,605. A year later, after paying off \$1,835 on the car, he defaulted and the finance company repossessed the car. The company promptly resold the car to the original dealer for \$400, which was well below its approximate wholesale value of \$700, as indicated in a dealer pricing guide called Redbook. The buyer had to pay the difference between the \$400 and his unpaid debt of \$770, plus repossession and selling expenses. Meanwhile, the dealer sold the car at retail for \$995, more than twice what he paid for it...

Auto dealers and finance companies deny they make any money from deficiency claims and assert they do everything possible to avoid repossessions... Nevertheless, repossession is clearly a big business, particularly nowadays, as layoffs and reduced overtime make it harder for consumers to meet payments. No comprehensive figures on repossessions are available, but...the Los Angeles Police Department estimates that it is notified of about 50 repossessions a day. That adds up to 18,000 a year in Los Angeles alone, and it doesn't include the many that aren't reported...

Nationally, estimates of defaulted auto installment debt range from \$700 million to more than \$1 billion a year. Total auto installment credit outstanding amounted to \$36.3 billion at the latest report.

In California, as well as in many other states, a repo man has total legal sanction to walk on to a defaulted debtor's property any time of the day or night to take back the car. In fact, it is...legal for him to grab a car from a closed garage as long as the garage door is unlocked...Most state laws also spell out that any surplus from the sale of a repossession goes back to the defaulting buyer. But in practice this is almost meaningless because a surplus practically never occurs.

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## TRUTH IN LENDING

Document 3: The "Truth in Lending" Act has done much to stop many of the illegal and unfair practices that once were to be found in the credit business. The act is explained here in an article taken from the *Federal Reserve Bulletin*, February, 1969.

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In approving the Truth in Lending Act, Congress said the informed use of credit stems from awareness of its cost. Truth in Lending fixes no maximum or minimum charges for credit. Purposes of the law and the regulation implementing it are to make customers aware of the cost of credit and to permit them to compare the terms available from a variety of credit sources.

Regulation Z applies to banks, savings and loan associations, department stores, credit-card issuers, credit unions, automobile dealers, consumer finance companies, residential mortgage brokers, craftsmen such as plumbers and electricians, doctors, dentists, hospitals, and any other individuals or groups which extend or arrange for consumer credit.

The final regulation parallels the proposed regulation published by the Board for comment on October 16, 1968. Some additions and language changes were made in the proposed regulation on the basis of comments received by the Board. The basic disclosures, which are required by the law itself, remain intact in the final regulation.

### Using Economic Methods

1. A Spending Plan for a Month (Table 2, page 47) compares actual and budgeted expenses. Why is it important to know both actual and budgeted expenses? What are some of the things that can be done if actual expenses are larger than budgeted expenses? What are some of the things that can be done if actual expenses are lower than budgeted expenses?
2. John prepared his budget for a week for a period of two months in advance. He finds that he will have a deficit (his expenses will be greater than his income) during the first week of each new month. What things can he do to make his budget balance?
3. What do you think are some of the things to be considered in making an economically-correct purchasing decision? What must you look for? What are some of the things you should do before you buy a product?
4. What information should you have before you sign an installment contract?

ˈek-ə-ˈnäm-iks/

## Knowing Your Vocabulary

*expenditure* /ɪk-ˈspen-di-cher/  
The money that you spend. 45

*budget* /ˈbaj-ət/  
A plan for spending money. 45

*allowance* /ə-ˈlau-ən(t)s/  
A sum of money given to an individual on a regular basis to help him cover his expenses. 45

*deficit* /ˈdef-ə-sət/  
A shortage of money caused by spending more money than has been earned. 46

*net contents* /ˈnet ˈkän-tents/  
The actual weight or amount of a product in a package. 49

*credit* /ˈkred-ət/  
Something entrusted to another, such as money or merchandise. 51

*creditor* /ˈkred-ət-ər/  
One who grants credit or loans money. 51

*debtor* /ˈdet-ər/  
One who receives credit or borrows money. 51

*interest* /ˈin-trəst/  
A sum of money that is charged for the use of money. 51

*charge account* /ˈchärj ə-ˈkaunt/  
An account opened with a store which allows a consumer to receive merchandise and pay for it at a later time. 52

*credit card* /ˈkred-ət ˈkärd/  
A charge card which may be used to obtain goods at many different businesses and stores. 52

*charge plate* /ˈchärj ˈplāt/  
An address plate used for identification of a consumer when charging merchandise, good at only one company's stores. 52

*due date* /ˈd(y)ü ˈdāt/  
The date on which a debt or bill must be paid. 53

*contract* /ˈkän-trakt/  
A legal agreement between two or more persons, having to do with things that each person promises to do in the future. 54

*legally binding*  
/ˈlē-gə-lē ˈbīn-dɪŋ/  
An agreement, usually a contract, that you are obliged by the law to live up to. 55

*down payment* /ˈdaʊn ˈpā-mənt/  
First payment on an installment purchase. The down payment must be made in cash at the time of the purchase. 55

*repossess goods*

/rē-pə-'zes 'gudz/

To take back goods from the consumer because he has failed to pay for them. 55

*finance charge*

/fə-'nan(t)s 'chärj/

The interest charged for an installment purchase. 56

*credit life insurance*

/'kred-ət 'lif in-'shür-ən(t)s/

An insurance policy that would pay off a debt if something happened to the debtor. 56

*penalty clause*

/'pen-əl-tē 'klöz/

A clause in an installment contract which explains what will happen if the debtor fails to make his payments. 56

*late charge*

/'lāt 'chärj/

A penalty charged for making a late payment on an installment contract. 56

*balloon contract*

/bə-'lün 'kän-, trakt/

A contract which provides for a very high final payment on an installment purchase. 57

*acceleration clause*

/ik-, sel-ə-'rā-shən 'klöz/

A clause in an installment contract providing that all of the payments become due if a payment is missed. 57

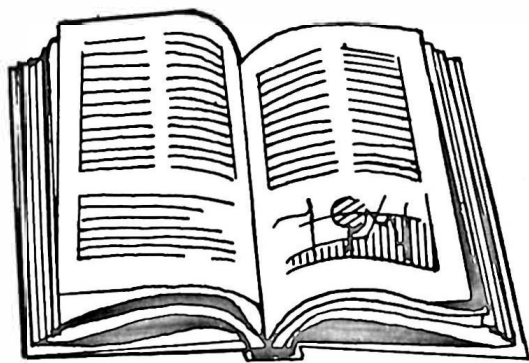
*wage assignment clause*

/'wāj ə-'sīn-mənt 'klöz/

A clause in an installment contract which allows a company to collect part of a debtor's wages from the debtor's employer until a debt is paid off. 57

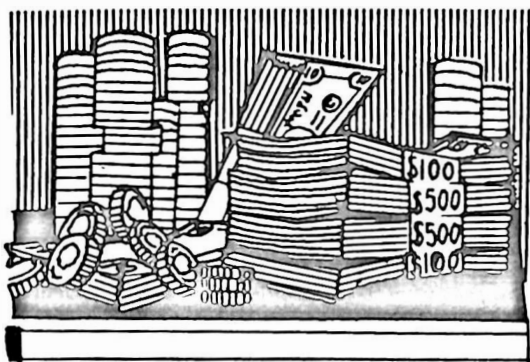
*garnishment* /'gär-nish-mənt/

A court order allowing a company to use a wage assignment clause to collect a debt. 57



**Reading the Text**

1. Why does the economic man prepare a spending plan?
2. What is a budget?
3. How do you prepare a budget?
4. How has odd-sized packaging made it difficult to shop wisely?
5. What are some of the reasons why a consumer might purchase goods on credit?
6. What are some of the questions you should answer before signing an installment contract?



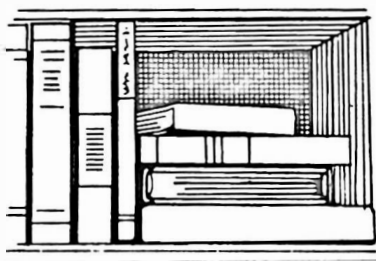
## Identifying Names and Terms

Fair Packaging and Labeling Act  
 Consumer Credit Protection Act  
 Truth In Lending  
 Installment contract

## Debating and Discussing Ideas

1. Read Document 1 about the dating of packaged food. If you were a producer or seller of goods, what would be your arguments against a law that requires that all products be clearly dated for freshness? Do you believe that it is important for goods to be dated for freshness? If so, why?
2. From reading Document 2 dealing with repossession of goods, how dangerous do you think it is to buy too many goods on credit? Do you think that creditors have or do not have the right to get their money any way that they can? Defend both sides of this argument.

3. Study Document 3. Note the date on which the Truth In Lending regulation became law. Now note the date of the article on the repossession of automobiles. Do you think that the Truth In Lending regulation has been of any real help in keeping people from trouble over credit purchases? If it has not, why do you think that this is the case?



## Reading Other Sources

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## 4. Money and Its Uses

*The use of money is all the advantage  
there is in having money.*

Benjamin Franklin  
Necessary Hints To Those That Would Be Rich



How was business carried on before money?

You take money for granted. You receive money as allowance or as payment for a job. With this money you buy goods and services.

Have you ever thought of what a great convenience money is? Can you imagine how it would be to get along without money? What would you use to buy goods? How would you pay your bills? There would be many difficult problems for you to face and to solve.

There was such a time. People have not always enjoyed the convenience of money. Before money most business was carried out by exchanging the goods of one seller directly for the goods of another seller. This form of carrying on business, still used in some parts of the world, is called *barter*.

Conducting business through barter has many disadvantages. Suppose that you are a farmer who needs some goods. You have no money with which to buy goods and services. But you do have a cow. In a barter economy, you will have to trade your cow for the goods and services. This will cause many difficulties.

In the first place, without money how will you be able to figure out the value of the goods to be bartered or traded? You have a cow to trade, and you want one pair of shoes. You realize that your cow is worth more than one pair of shoes, but how much more? How many pairs of shoes can you get

for your cow? Perhaps 25, perhaps 30? If you can get 30 pairs of shoes for your one cow, how will you be able to trade for one pair without butchering the cow and trading one-thirtieth of its remains for one pair of shoes?

In the second place, you may not always be able to find someone who has exactly what you want, and wants exactly what you have to trade. Again, you are a farmer who wishes to trade your cow, but this time for some wheat. But you can find no one who wants to trade wheat for a cow. Instead, you find a second farmer who will trade a bale of cotton for a cow. So you make this trade. You still do not have your wheat, and you can still find no one who will trade wheat for your bale of cotton. However, you find a farmer who will trade a dozen bushels of potatoes for your bale of cotton. Now you have potatoes, but still no wheat. Finally, you find a man who will trade wheat for your potatoes. You have been very lucky. In a true barter system it is just as likely that you would spend a long time trading and never get your wheat.

In the third place, you will not be able to make a contract in a barter system. For example, you hire a man to work on your farm for one year. For this one year's work, you promise to pay him five hundred bushels of wheat. He would then have to barter his wheat for his wants and needs.

However, what if all of the farmers grew too much wheat in that year? This would mean that people might not want to trade for wheat. How could your worker get other goods if he were unable to trade his wheat? Your worker would not receive a full fair exchange of goods for his work.

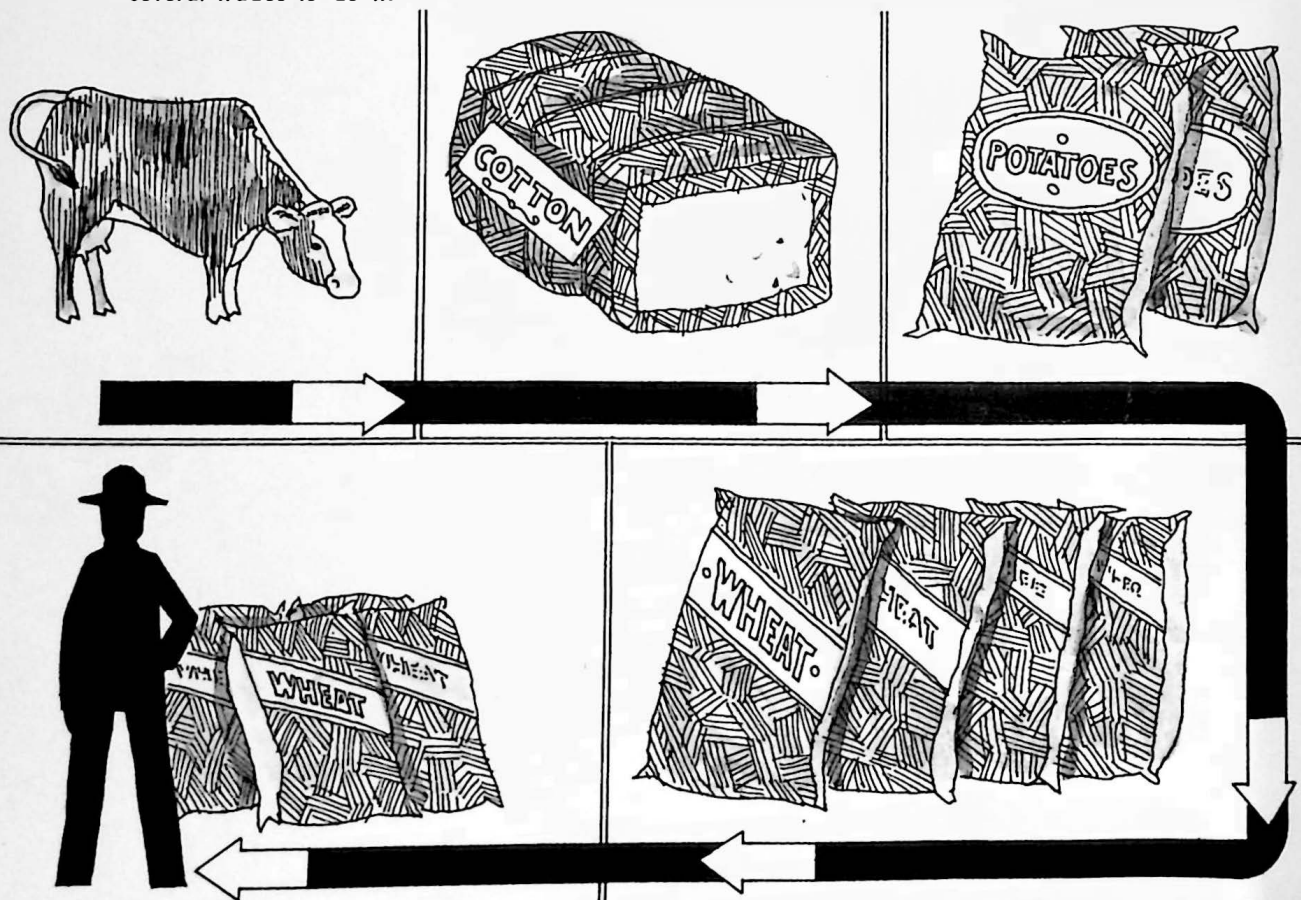
At the time of the signing of a contract, neither you nor your worker could know the value of what you promised to pay him. In the barter system, values of goods change easily and quickly. This makes use of contracts very risky.

Finally, it will be impossible for you to save for the future in a barter system. If you try to save for your future, you can only store

up what you have produced yourself, or what you have gained by trading. Many of the goods that you might try to save would not be very long-lasting goods. Wheat would begin to spoil. Cows would grow old and die. Other goods, such as shoes or bales of cotton, might be more long-lasting. But they would be difficult to store in large amounts over a long time.

Because of these many disadvantages, people began to search for ways to make their trading easier. One way was for all of the members of the society to settle on one thing that all of them would accept in trade. This thing would then become that society's *medium of exchange*, or *money*.

The farmer finally bartered for his wheat. But it took him time, inconvenience, and several trades to do it.



How did money develop into its present form?

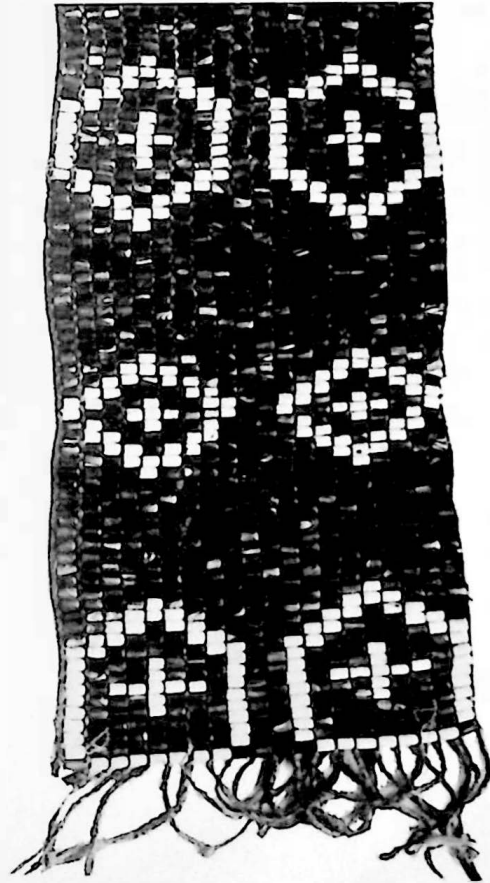
Throughout history, many different things have been used as money. At one time or another salt, feathers, shark's teeth, clam shells, and tobacco have served as mediums of exchange. The North American Indians used belts and sashes made of beads and shells as their money. They called this money *wampum*. The Spartans of ancient Greece made large rings and bars of iron their medium of exchange. In our own time, many of the peoples of Africa use herds of cattle as their form of money.

Precious metals, such as gold and silver, became a popular medium of exchange in many cultures. The reasons for this choice were many. People found the precious metals

to be attractive because of their color and shine. Everyone wanted some gold or silver. They were willing to accept them, in trade for almost anything.

When precious metals became popular and desirable, they also became easy to recognize. It was difficult for anyone to substitute other metals for precious ones.

Further, the precious metals were *durable*, or long-lasting. They did not decay or wear away very quickly or easily. They would not rust away as iron would. They could not run away



Wampum was used as money by the American Indians. Many different things have been used as money throughout history.

or die as cattle could. The precious metals could be stored and saved for future use. They would last over great periods of time without losing their value. Contracts could be based on their value.

Finally, the precious metals became a medium of exchange because they were scarce. The fact that their supply was low, added to the fact that the demand for them was high, meant that they became valuable.

Originally, men simply traded *nuggets*, pieces of gold or silver from the ground, for the things that they wanted. But soon this simple trading became difficult. A man had to be very lucky to find someone with just the right size nugget to buy what he wanted to sell. Further, it was hard to tell

how much of the nugget was gold and silver, and how much was earth and rock. The trade value of different-sized nuggets was almost impossible to set. There was very little difference between this and exchange by barter.

To try to solve this problem, people began to melt the precious metals out of the ore and to cast them into blocks or bricks called *ingots*. This made it easier for people to set the trade value of gold or silver, but it caused other problems. The ingots were usually large and very valuable. They could be used for only large purchases. Small purchases still had to be made by barter. Furthermore, ingots of gold or silver were heavy and bulky. They were difficult to carry around.

Gold is still the medium of exchange between nations. This \$2 million in gold is part of the gold reserves of the United States.



In time the precious metals were made into coins. Coins came in many sizes and many values. Precious metals in the form of small coins could now be used for the smallest purchases. The size and shape of coins also meant that they could be much more easily carried than ingots. This encouraged their wide use as a medium of exchange. 572 9

#### What are the two values of money?

After many centuries, people who studied money discovered that it actually had two values. Money had an *intrinsic* value and an *extrinsic* value.

Every medium of exchange has both an intrinsic value and an extrinsic value. The intrinsic value of money is the value of the thing being used as money. For example, money made from silver has a high intrinsic value. Money made from paper has a low intrinsic

value. This is simply because silver is expensive and scarce, and paper is plentiful and cheap.

The extrinsic value of money is the value that people give to it as a medium of exchange. In our society, the extrinsic value of both silver and paper money is exactly the same. One dollar's worth of silver half-dollars will buy the same goods and services that one paper dollar will.

After money began to be used, metal coins were cast in many different shapes, sizes, weights, metals, and denominations.

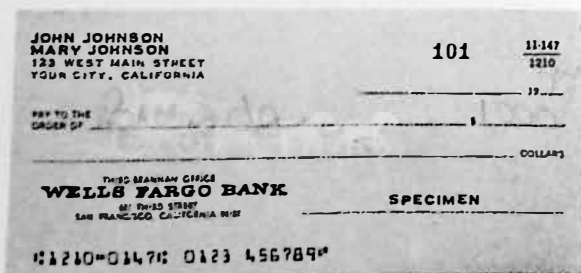


During the time that precious metals were the medium of exchange, money had both a high intrinsic and a high extrinsic value. One effect of this was that money became more scarce.

Precious metals were scarce to begin with. This meant a limited supply of money. People began to

hoard money. They kept it not for what it could buy, but just to save the precious metals from which it was made. Often they melted money to make jewelry and other ornaments. This caused serious problems. There was less and less money in circulation. People were forced to return to doing business through barter.

The discovery of the two values of money changed all of this. People found that money's extrinsic value was often much greater than its intrinsic value. Money no longer had to be made from precious metals. With this, it became possible for governments to issue and to use paper money. Money's most important value became its value as a medium of exchange.



Currency, coins, and check-money are the three types of money which we have. All are accepted in payment for goods and services.

What is the nature of money?

Money is anything which is accepted by a society as its medium of exchange. In the modern United States, paper cash, metal coins, and paper checks are all used as money.

A *check* is an order to pay cash made by the owner of a *checking account*. A checking account is a sum of money deposited in a bank. A check can be written for any amount. The only thing that matters is that the person writing the check has as much money in his account as the amount of the check. When the owner of the account writes a check against his account, the bank must pay cash as directed.



The production of legal tender requires many skilled men and intricate machinery. Printing presses, sorting machines, and coin bagging machines are shown in operation in these pictures. Other skilled men and women also work as designers, artists, and engravers. Still others inspect, count, and cut currency before it is shipped to banks for distribution. These are just a few of the people and things utilized by the government as it "makes money."

Denomination		Front	Back
GINA WALLS WAS here 8th gr.	\$ 1.00	George Washington	"One" and U.S. Seal
	2.00	Thomas Jefferson	Monticello
	5.00	Abraham Lincoln	Lincoln Memorial
	10.00	Alexander Hamilton	U.S. Treasury
	20.00	Andrew Jackson	White House
	50.00	Ulysses S. Grant	U.S. Capitol
	100.00	Benjamin Franklin	Independence Hall
	500.00	William McKinley	"Five Hundred"
	1,000.00	Grover Cleveland	"One Thousand"
	5,000.00	James Madison	"Five Thousand"
	10,000.00	Salmon P. Chase	"Ten Thousand"
	50,000.00	Carter Glass	Spread Eagle
	100,000.00	Woodrow Wilson	"One Hundred Thousand"

Although a check is money, a check is not *legal tender*. Legal tender is money that has been issued with the permission of the federal government. The government has declared legal tender to be the official medium of exchange. Legal tender is made up of cash and coins.

Only the United States Treasury and the Federal Reserve Banks (which you will learn about in the next chapter) have the permission of the government to issue cash and coin. Money issued without the permission of the government is called *counterfeit* money.

What are the different kinds of legal tender?

Many different kinds of cash and coin are issued as legal tender.

If you look at the table of values, or *denominations*, of the United States paper money in circulation, you will see its many values.

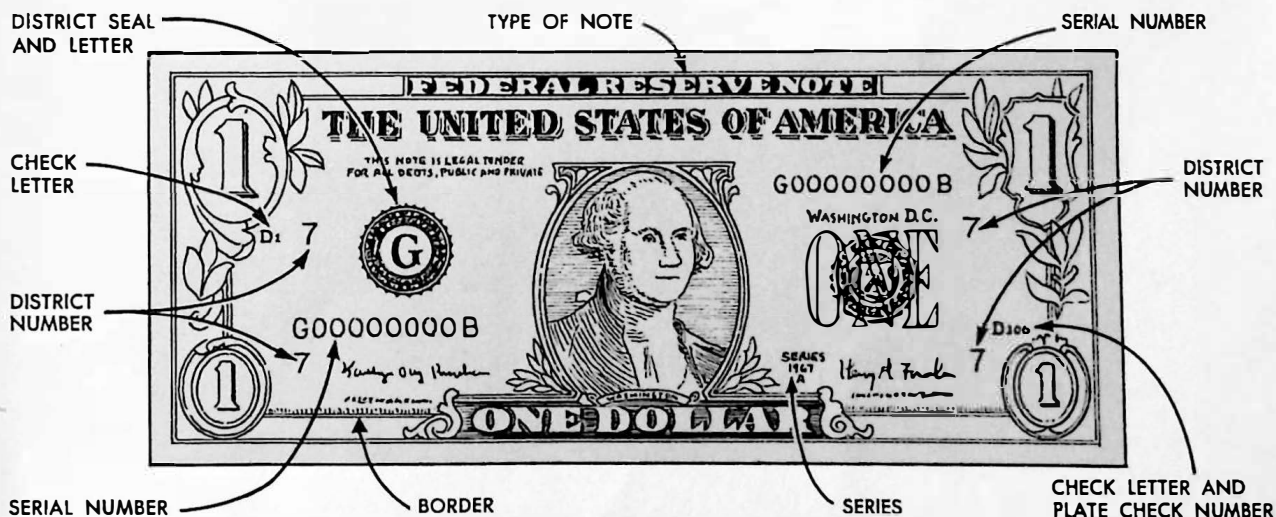
Coins in circulation can be either *standard coins* or *token coins*. A standard coin is one which contains an amount of precious metal that is equal in value to the amount stamped on it. Its intrinsic and extrinsic values are the same. A token coin contains precious metals that are worth less than the amount stamped on the coin. For example, the actual value of the silver in a brand new fifty-cent piece is only a few cents. There are still many standard coins in circulation, but since the middle of 1965 the United States Treasury has been issuing only token coins.

Paper cash, or dollars, consists of *United States Notes* and *Federal Reserve Notes*. Until recently there was a third kind of paper cash recognized as legal tender, the *Silver Certificate*. The Silver Certificate was backed by the government's reserve of silver. Although you may still find some Silver Certificates in circulation, they are gradually being retired by the U.S. Treasury.

Paper cash can also be either standard or token money. United States Notes are standard money. They are backed by the government's reserve of gold. There are very few United States Notes in circulation. They are also being retired by the government.

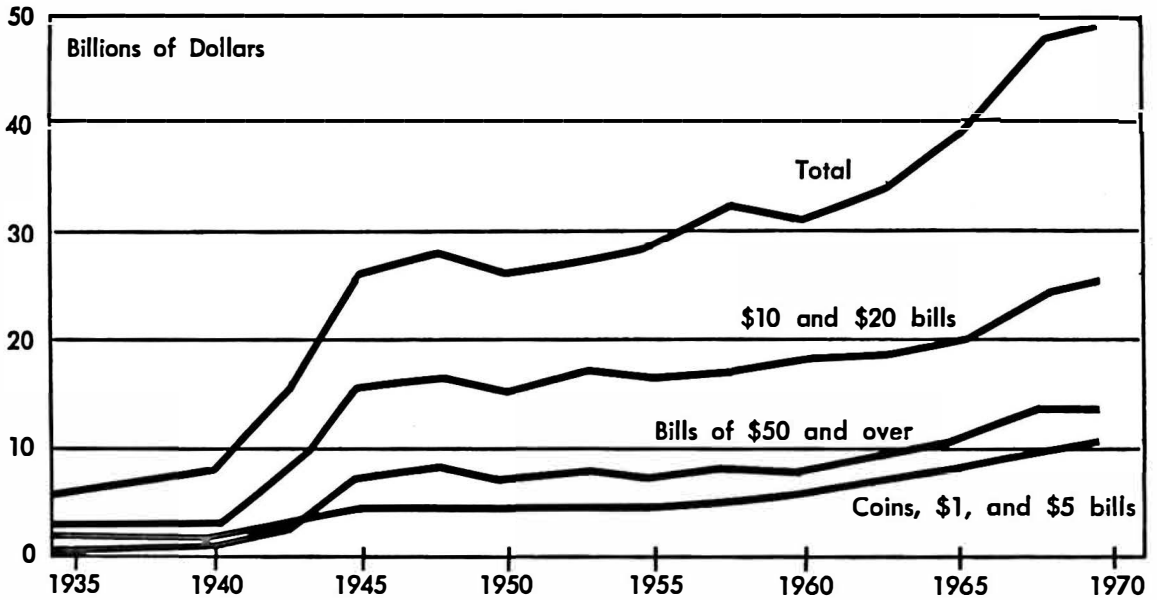
Most of the paper cash in circulation is made up of Federal Reserve Notes. Federal Reserve Notes are token cash. They are backed up only by our government's promise that they are worth the amount printed on the face of the bill. Another name for token cash is *fiat money*. Fiat money is cash that has no reserve of precious metals to back it up. Most of the cash in circulation in the world today is fiat money.

If you have any paper cash or coins in your pockets, take it out and check to see what kind of cash it is. Do you think that it makes any difference whether the money that you have is standard or token money?



HOW CAN YOU TELL COUNTERFEIT MONEY?		
	True Money	Counterfeit Money
Portrait	Portrait and background are sharp and clear	Portrait and background are not clear; eyes of the portrait are usually dull
Serial numbers	Numbers are all the same size and carefully lined up	Numbers are poorly spaced, blurred, or poorly lined up
Border	Made of a series of fine white lines; look like lace	Lines are either too light or dark; they are often blurred

CURRENCY IN CIRCULATION BY DENOMINATION



Source: 1968 Historical Chart Book of the Board of Governors of the Federal Reserve System.

How can it be said that all money is debt?

You know that the form of money must be accepted by a society to be used as money. You know that it is a medium of exchange. You know that it can be exchanged for goods and services. Money also settles debts.

You know that money is made up of checks, paper cash, and metallic coins. But money is more than just paper or metal. Money is more than just a medium of exchange. Money also plays a part as debt. Money is not only payment for a good or a service. At the same time money is also a promise to pay.

Checking accounts are also called *demand deposits*. Everytime a *depositor*, the person who deposits money in a bank, writes a check he orders his bank to pay

a sum of money. The depositor may demand the full amount in his account at any time. The bank is legally obliged to pay. These demand deposits become the debts of the bank.

You have already learned that most of the paper money is made up of Federal Reserve Notes. These are the promises to pay, or the debts, of Federal Reserve Banks. Even United States Notes are debts. They are the promises to pay, or the debts, of the United States Treasury.

Money as debt plays a very important role. It creates a network of responsibility over the entire economic structure. The economic structure is completely connected by this system of payment and promise to pay. Money as debt keeps all parts of the economy related and unified.

## HOW IMPORTANT IS COMMUNICATION IN MONEY MATTERS?

Document 1: Whenever you buy or sell something, be careful that you fully understand all of the terms of the deal. This story illustrates a business deal where neither buyer nor seller really understood what the other had in mind.

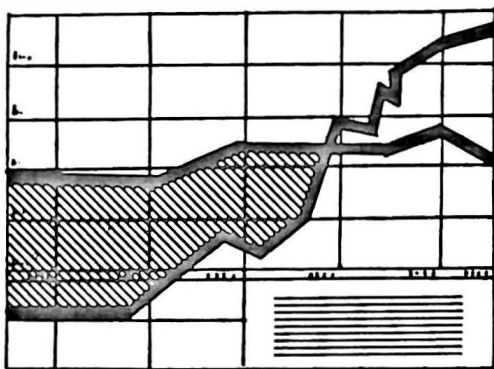
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You should all be familiar with the story of how Dutch explorers in the 17th century purchased the Island of Manhattan from the Brooklyn Indians. The Dutch gave the Indians beads and trinkets for the island. To the Dutch, these beads and trinkets were worth about sixty *guilders*. Guilders were, and still are, the legal tender of the Dutch government. These sixty guilders would be worth about twenty-four of our American dollars today. This sum is not very much money today. It was not very much money to the 17th century Dutch either.

In return, the Indians gave the Dutch the Island of Manhattan. At that time, Manhattan Island was covered with large stocks of valuable timber. It was inhabited by many valuable fur-bearing animals. The waters surrounding the island were filled with every imaginable kind of fish. It seemed to the Dutch that they had purchased a paradise.

Both the Indians and the Dutch were sure that they had got the best of the bargain. Both the Indians and the Dutch were sure that they had cheated one another. And they were both right. Within the Indian society, the Indians had made a good business deal. They had received much, much more than the land was really worth.

Within the Dutch society, the Dutch explorers had made the buy of a lifetime. For the investment of a few guilders worth of trade goods, they had received the beginning of an empire in the New World.



### Using Economic Methods

1. Study the line graph showing the currency in circulation by denomination. Answer all the following questions using the information from the graph.
  - A. What happened to the total amount of the currency in circulation in the years 1935 to 1968?
  - B. What was the approximate total amount of currency in circulation in the year 1968?
  - C. What was the approximate total amount of the following currency in circulation in the year 1947?
    - (1) Coins, \$1 and \$5 bills
    - (2) Bills of \$50 and over
    - (3) \$10 and \$20 bills
2. Using a blank sheet of paper, construct a bar graph which will show the amounts of each kind, and the total of currency in circulation in the year 1945.
3. What is the difference between the intrinsic and the extrinsic values of money? Using a blank

sheet of paper, construct a table which shows if the following forms of money have an intrinsic or extrinsic value. If the money is both extrinsically and intrinsically valuable, list it under both headings.

Eagle feathers  
 Shark's teeth  
 Silver ingots  
 Wampum  
 Twenty dollar gold piece  
 Mink furs  
 Sea shells  
 1954 half dollar  
 1970 half dollar  
 A check for fifty dollars

4. Construct a table showing the advantages and disadvantages of business by money and by barter. Which one has the most advantages?

ˈek-ə-näm-iks

### Knowing Your Vocabulary

*barter* /ˈbärt-ər/

Business conducted by exchange of goods and not an exchange of money. 67

*money* /'mən-ē/

Anything accepted by a society as a medium of exchange. 68

*wampum* /'wām-pəm/

Belts of polished shells and beads used by the Indians as money. 69

*ingot* /'ɪŋ-gət/

Bar or brick made of precious metals. 70

*intrinsic value*

/ɪn-'trɪn-zɪk 'væl-(, )yü/

The real value of a thing used as money. 71

*extrinsic value*

/ek-'strɪn-zɪk 'væl-(, )yü/

The value as a medium of exchange given to anything being used as money. 71

*check* /'tʃek/

A written order demanding a bank to pay money as instructed. The bank is obliged to pay as long as there is enough money in the account to cover the check. 72

*denomination*

/di-nām-ə-'nā-shən/

Extrinsic value of money. 74

*legal tender* /'lē-gəl 'ten-dər/

Paper cash and coins that the government has declared to be money. 74

*standard coin*

/'stān-dərd 'kōɪn/

A coin containing an amount of

precious metal equal in value to the amount stamped on the coin. 74

*token coin* /'tō-kən 'kōɪn/

A coin which contains precious metals that are worth less than the amount stamped as the coin's value. 74

*dollar* /'dāl-ər/

A debt, or the promise to pay, of the Federal Reserve Banks or the United States Treasury. Used in our society as money. 75

*United States Note*

/yü-'nīt-əd 'stāts 'nōt/

Paper money backed by our government's reserve of gold. 75

*Federal Reserve Note*

/'fed-(ə)rəl ri-'zərv 'nōt/

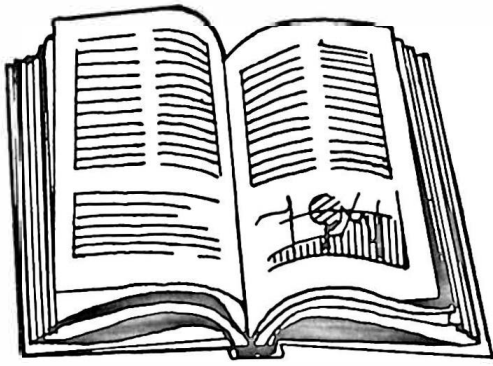
Paper money that is issued by the Federal Reserve Bank with the authorization of the United States government. A note is backed up only by the promise of our government to pay. 75

*fiat money* /'fī-at 'mən-ē/

Cash that has no reserve of precious metals to back it up and does not have full value of precious metal in itself. Fiat money cannot be redeemed for standard money. 75

*demand deposit* /di-'mand di-'pāz-ət/

An account against which checks are written. The check "demands" that the bank pay money as it is instructed. 76



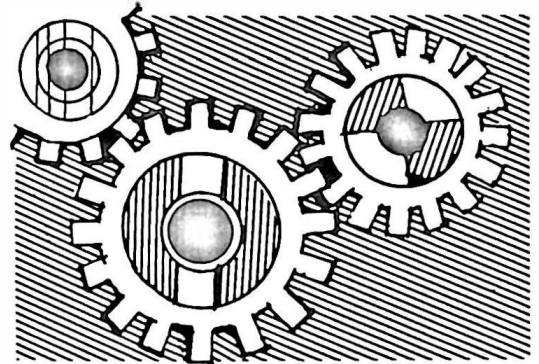
### Reading the Text

1. Why is business by barter impossible in an advanced civilization such as ours?
2. Name some of the different things that have been used as money throughout history.
3. What were the reasons that gold and silver became popular mediums of exchange?
4. What are some of the forms of modern money in use in the United States?
5. What is counterfeit money?
6. How can you tell if the money you have is counterfeit money?
7. What is the difference between standard and token money?
8. How can it be said that money is also a debt? What is the importance of money as debt in our economic society?

9. What are the differences between United States Notes, Federal Reserve Notes, and Silver Certificates? Which of these is fiat money?
10. What do we mean when we say that something is durable? Are there any advantages to something being durable? List the advantages.

### Identifying Names and Terms

Medium of exchange  
Federal Reserve Note  
Token money  
Debt



### Debating and Discussing Ideas

1. Study the story of the Manhattan Island deal. How could both sides be satisfied with this deal? What was the medium of exchange for the Dutch? What do you think was the medium of exchange for the Indians? How did this affect the deal? Do you think that

there was a lack of communication between the Indians and the Dutch? If so, how did this lack of communication help to make the Manhattan Island deal a bad exchange?

2. Why do you think that it is important for a society to settle on a single medium of exchange? What are some other things besides cash or coin that everyone in our society might accept as a medium of exchange?
3. Why did our government begin to issue token money instead of standard money? Do you think that the use of token money has any advantages over the use of standard money? What might some advantages be?
4. Why is the extrinsic value of money more important than its intrinsic value? How can something have two values?

### Reading Other Sources

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## 5. Banking and Interest Rates

*Modern banks gradually evolved from the old goldsmith establishments in which money and valuables were stored. The practice finally became general of holding far less than 100 percent reserves against deposits, the rest being invested in securities and loans for an interest yield.*

From *Economics, An Introductory Analysis*, by Paul A. Samuelson. Copyright 1961, McGraw-Hill Book Company. Used with permission of the McGraw-Hill Book Company.



What is a financial institution?

There are special organizations for the care and handling of money in our economic society. They accept deposits of money from consumers and businessmen for safekeeping. These organizations then lend some of this money to other consumers and businessmen. Their most important job in our economic structure is this transfer of buying power. Buying power is shifted from the depositors, who have more money than they need, to the borrowers, who need more money than they have. Because their main concern is with money, these organizations are known to people everywhere as *financial institutions*.

What are the different kinds of financial institutions?

There are many different kinds of financial institutions. They all do more or less the same things. They all help transfer the buying power. The most important of our financial institutions are *commercial banks*, *savings banks*, and *savings and loan associations*.

The major difference between these different financial institutions is that only the commercial banks will accept demand deposits, or checking accounts.

These institutions are alike in that they all accept money in the form of *time deposits*. Time deposits are accounts that are restricted in some way. Some of them, such as savings accounts,

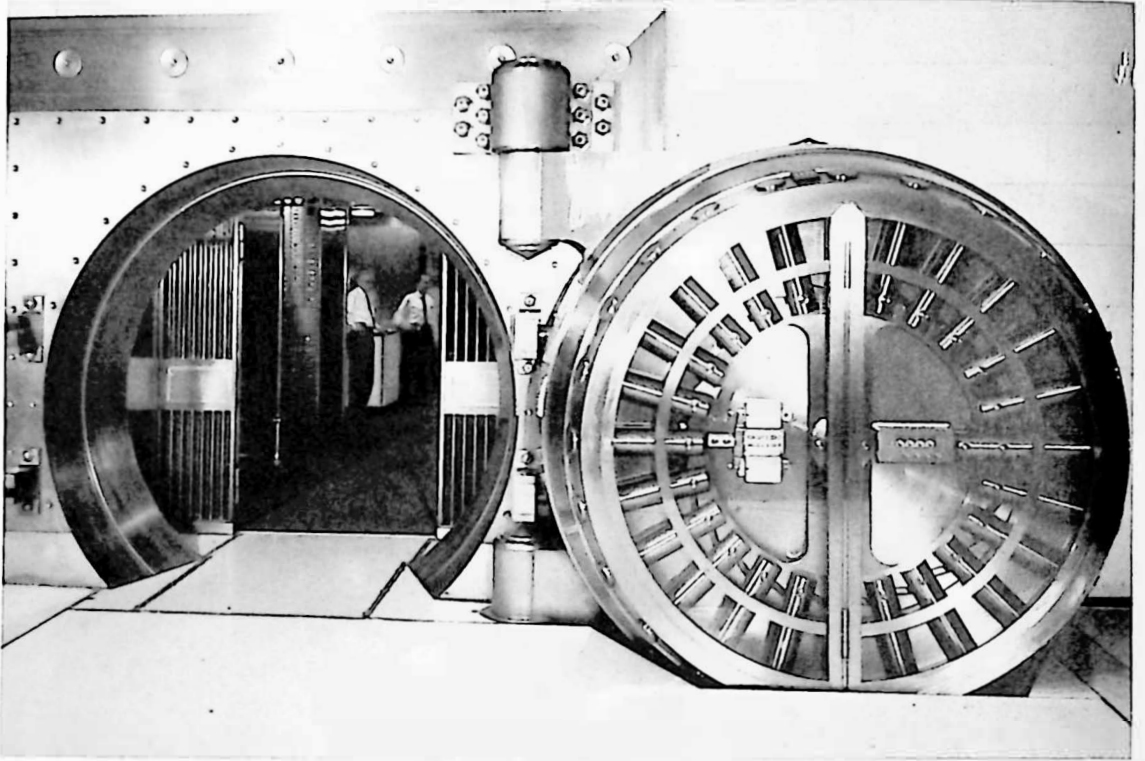
may require a written notice before any money can be taken out, or *withdrawn*. The notice of the withdrawal must be given one to three months before the actual withdrawal. Normally, this rule is not held to for the deposits of the individual consumer. Other time deposits, called *certificates of deposit*, cannot be withdrawn by the depositor before the end of a certain period of time.

Credit unions, finance companies, and insurance companies are also financial institutions. In one way or another all of these institutions take part in the transfer of buying power.

What are some of the services that financial institutions perform?

As you have seen, the main purpose of financial institutions is to transfer buying power. However, before buying power can be transferred, depositors must be willing to trust the banks and savings and loan associations with their money. Consumers and businessmen are willing to trust their money to the financial institutions because of the many useful services that these organizations perform for us.

In the first place, they are safe places in which to keep money. Most people would rather deposit their extra money in a bank than to store it in their own homes. Most businesses would prefer to deposit their money in a bank than to keep it in their own vaults.



The vaults of banks and savings and loan associations stand as the symbols of the safety of the depositors' money.

Deposits in commercial banks are protected against possible loss by more than just the strength of strong vaults. Commercial banks are protected against possible loss by the Federal Deposit Insurance Corporation, or F.D.I.C. The deposits in savings associations are protected by the Federal Savings and Loan Insurance Corporation, or F.S.L.I.C. These two organizations are departments of the federal government. They guarantee the safety of the deposits in all their member banks and associations. However, there is a limit on the amount of individual deposits these organizations will insure. They will insure deposits up to \$20,000.

Further, in the case of commercial banks, banking is a convenience. Commercial banks accept demand deposits in the form of checking accounts. Many consumers and businessmen find it easier and safer to pay their bills and make their purchases with checks, or check money, than with cash. If you have a checking account, you do not have to keep or carry around large amounts of cash with which to do business. If your checks are lost or stolen, or you decide for some reason not to pay a check, you may give your commercial bank a *stop payment order*. The bank will refuse to pay any money on a check that has a stop payment order placed on it.

Finally, people are willing to deposit their money in banks and savings and loan associations because all money kept in their time deposits earns interest. You will remember that interest is a sum of money that is paid for the use of money. Money kept in time deposits earns interest because the financial institutions use this money to make *loans*.

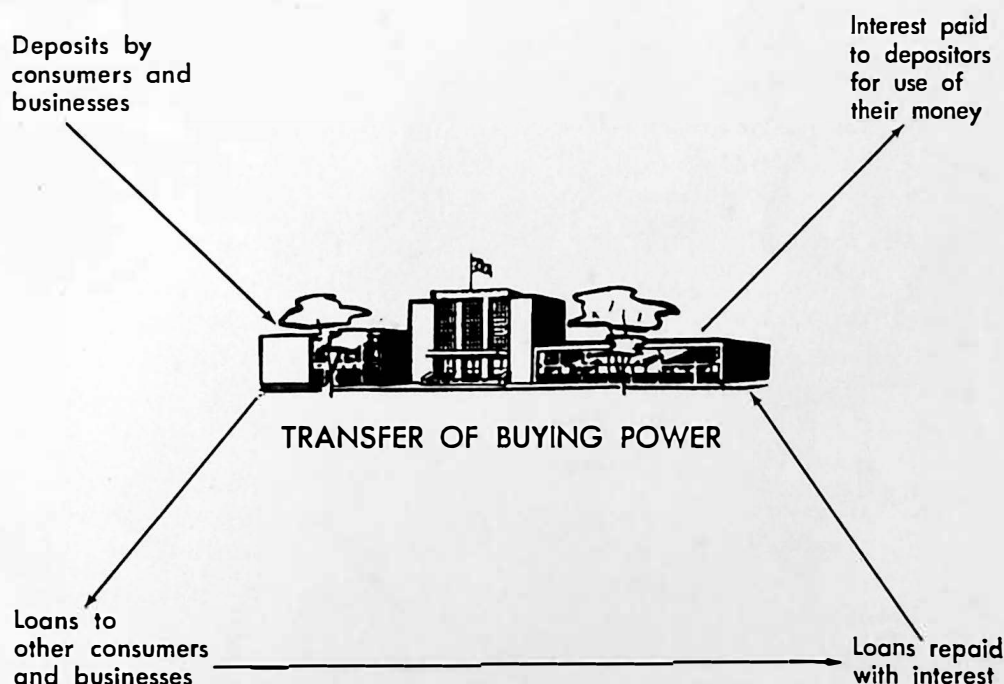
A loan gives a consumer or a business the temporary use of money on the condition that this money be repaid. As the loan is repaid, the borrower pays interest for the use of the money.

At certain times of the year, part of the interest paid by all of the bank's borrowers is paid to the people who have deposited

their money in the bank. This is the bank's payment to the depositors as the charge for their use of the depositor's money.

How can you figure simple interest?

You pay interest when you borrow money. You receive interest when you save money. You know that interest is the charge for the use of money. There will probably be a time when you will either pay or receive interest. For your own protection, you should know how interest is figured. This section and the next show exactly how this is done. Study them carefully, and you will be able to be sure that you will never have to pay too much, or receive too little interest.



The interest rate is shown as a percent per year. The formula for figuring simple interest is  $I = P \times R \times T$ . In this formula, I is the amount of interest. P is the *principal*, the amount of money borrowed or saved. R is the rate of interest paid or charged. T is the length of time for which the money is borrowed or saved. In all of the following problems we will be using a *commercial*

*year*. The commercial year, or business year, consists of 360 days. This is different from a calendar year which is 365 days.

To explain the method of figuring interest, three examples are shown. The answers are given to the first two examples. The third is a problem that you may try to solve. The answer to the third problem can be found at the end of the chapter.

Problem 1: Your parents have borrowed \$1000 from a bank for a period of one year. The interest rate is 10 percent. How much interest must your parents pay? To solve this problem, use the formula  $I = P \times R \times T$ .

$$I = P (\$1000) \times R (.10) \times T (360/360)$$

In this problem the interest rate is shown as a decimal. The amount of time is shown as a fraction in which the numerator is the number of days for which the money is borrowed. The denominator will always be 360. This is the number of days in the commercial year. Can you solve this problem and find the simple interest?

$$\begin{array}{r} \$1000 (P) \\ \times .10 (R) \quad 100 \times 360/360 (T) = 100 \times 1 = \$100 \\ \hline \$100.00 \end{array}$$

The answer is that your parents will have to pay interest of \$100 for the use of the \$1000 for one year.

Problem 2: Now your parents borrow \$500 from a bank for a period of 180 days. The rate of interest is 8 percent. How much interest will they have to pay?

$$\begin{array}{r} \$500 (P) \\ \times .08 (R) \quad 40 \times 180/360 (T) = 40 \times \frac{1}{2} = 40/2 \text{ or } \$20 \\ \hline \$40.00 \end{array}$$

The answer is that the interest will be \$20.

Problem 3: You have borrowed \$12 from a friend for a period of 30 days. The rate of interest is 10 percent. How much interest will you have to pay? Remember the formula:

$$I = P (\$12) \times R (.10) \times T (30/360)$$

How can you figure compound interest?

If money is deposited in a savings account for a number of years, then the total amount of interest earned over those years is called *compound interest*. Compound interest is interest figured on the

amount of the original deposit, plus the interest already earned. The problems below show how to figure compound interest. Study the first two examples, then do the third problem yourself. The answer is at the end of the chapter.

Problem 1: Your parents deposit \$1000 in their savings account. The bank pays interest at the rate of 5 percent per year. How much interest will your parents have earned after two years?

This problem can be solved by figuring simple interest on \$1000 for the first year. For the second year, the interest must be figured on \$1000 plus the interest earned the first year. Add the interest income earned the first year to the interest income earned the second year. The sum is the compound interest for a period of two years.

$$\begin{aligned}\text{First year: } P (\$1000) \times R (.05) \times T (360/360) &= I (\$50) \\ \text{Second year: } P (\$1,050) \times R (.05) \times T (360/360) &= I (\$52.50)\end{aligned}$$

Then add the interest earned in the first year to the interest earned in the second year.

First year	\$50.00
Second year	<u>52.50</u> (compound interest)
Amount of total interest	\$102.50

Problem 2: Your parents deposit \$500 for you in your savings account. The bank pays interest at the rate of 6 percent per year. How much interest have you earned after three years?

$$\begin{aligned}\text{First year: } P (\$500) \times R (.06) \times T (360/360) &= I (\$30.00) \\ \text{Second year: } P (\$530) \times R (.06) \times T (360/360) &= I (\$31.80) \\ \text{Third year: } P (\$561.80) \times R (.06) \times T (360/360) &= I (\$33.71)\end{aligned}$$

Then add the interest earned in the first, second, and third years.

First year	\$30.00
Second year	31.80 (compound interest)
Third year	<u>33.71</u> (compound interest)
Amount of total interest	\$95.51

Problem 3: You deposit \$300 in your savings account. The bank pays interest at the rate of 5 percent per year. How much interest will you have earned by the end of one year? How much compound interest will you have earned by the end of the second year? What is the total amount of interest that you will have earned by the end of the three years?

**How can savings banks and savings and loan associations help you?**

Besides giving you the chance to earn interest in their time deposit accounts, savings banks and savings and loan associations can help you finance your most important purchase. These financial institutions specialize in making loans for the purchase of homes.

Consumers who buy homes are faced with a special problem. Buying a home may well be the most costly purchase that they will ever have to make. Most people do not have enough money saved to pay for the entire cost of a home. They may be able to pay for part of the cost of the home

Financial institutions lend money to many people for many reasons. This couple is borrowing to buy a new car.



from their savings. But they will have to borrow the rest of the money. The time deposits of savings banks and savings and loan associations are often loaned to people who wish to buy homes.

To make sure the bank will get its money back, the borrower must offer some *collateral*. Collateral is something about equal in value to the money borrowed. The bank requires persons borrowing money for a house to sign a *mortgage* as their collateral. A mortgage is a claim placed upon the title or deed to a home. The bank holds this claim for as long as it takes the home buyer to repay the loan.

If you bought a home and had a mortgage on it, you could live in it until you repaid the loan. You would be required by law to repay the money, with interest, to the bank or association. After the loan was repaid, the bank would no longer have any claim on the deed to the home. The mortgage would be paid up. If you did not repay the loan, the bank or association would be able to put you out of the home and sell it to someone else.

Home mortgages are made for long periods of time. Most home mortgages are made for ten years or more. The borrower must make regular mortgage payments of a part of the loan and the interest. These payments usually are made monthly until the entire amount of the mortgage loan has been

repaid. In many ways the mortgage loan is very much like the installment loan. The major difference is the amount of money involved, and the amount of time that you will have to take to pay off the mortgage loan.

**What are commercial banks and what do they do?**

Commercial banks do many important jobs. They accept time and demand deposits from businesses and consumers. They make loans to businesses and consumers. Also, they are used by the Federal Reserve System to control the supply of money in the economy. This will be explained further in the next section.

Businessmen deposit most of the money they receive in their commercial banks. When businesses pay their bills, they write checks against these deposits. Almost all business expenses are paid for by check. Businessmen prefer to use checks because these are more convenient than cash. Checks also provide a record of payment. Many individual consumers also have demand deposits at commercial banks. Along with their demand deposit accounts, commercial banks also accept time deposits. They have special savings departments just for time deposits.

Commercial banks make loans for many purposes. They make installment loans to consumers for the purchase of goods. At times commercial banks will make mort-

gage loans. But commercial banks specialize in *short-term commercial* loans. A commercial loan is a loan which is made to a business rather than to an individual consumer. A short-term loan is one which must be repaid within a year or less. Usually short-term loans run for periods of one, three, six, or twelve months.

The most important kind of loan that a commercial bank makes is the *short-term, self-liquidating* loan. A self-liquidating loan is one in which the borrowed funds are used to buy goods which are meant to be resold. Hopefully, the borrower will be able to sell the goods for more money than he paid for them. This will allow him to repay the loan, and still make a profit for himself. A large percentage of the business carried on by our businessmen is done through the use of the short-term, self-liquidating loan.

Whenever you make a loan from a bank, or from any financial institution, you will have to sign a *promissory note*. A promissory note is your written promise to repay the amount of your loan, plus interest, on the loan's due date.

The amount of the interest you will have to pay depends on whether your loan is *secured* or *unsecured*. A secured loan is one for which collateral, some article of value, has been given as security by the borrower to the lender. An unsecured loan has no collateral to guarantee it.

Although the commercial banks give service mainly to businessmen, they also offer these same services to the individual consumer. You and your family may have a demand or time-deposit account, or get a short-term loan, or get an installment loan at a commercial bank. There are more commercial banks than other financial institutions. It would be difficult for the economy to continue working on a day-to-day basis without the services of the commercial banks. You can ask at your local bank to find out what services they provide.

What is the special importance of the commercial banking system?

The commercial banking system is the only one of the financial institutions that can create money. This gives special importance to the commercial banking system.

Commercial banks cannot print or destroy legal tender. Only the United States Treasury or the Federal Reserve Banks can do that. Commercial banks can create or destroy money by their use of check money. Commercial banks can create or destroy check money through their control over demand deposits. A glance at the tables will show you that this process is not as difficult as it sounds.

Suppose that you have just deposited \$500 in your commercial bank. If you look at Table 1, you will see how the commercial banking system can turn this \$500 into \$1200 in buying power, or

money. If this process were carried as far as it would go, you would find that for every dollar deposited, the commercial banking system could create \$5 worth of demand deposits, or check money.

The process works in this way. According to law, banks must keep about 20 percent of their deposits. This is called a *legal reserve*. They can lend up to 80 percent of their deposits. This means that out of your \$500, your bank has to keep only \$100 as part of its legal reserve. This leaves them with \$400 to be loaned. Table 1 will show you in detail what will happen now.

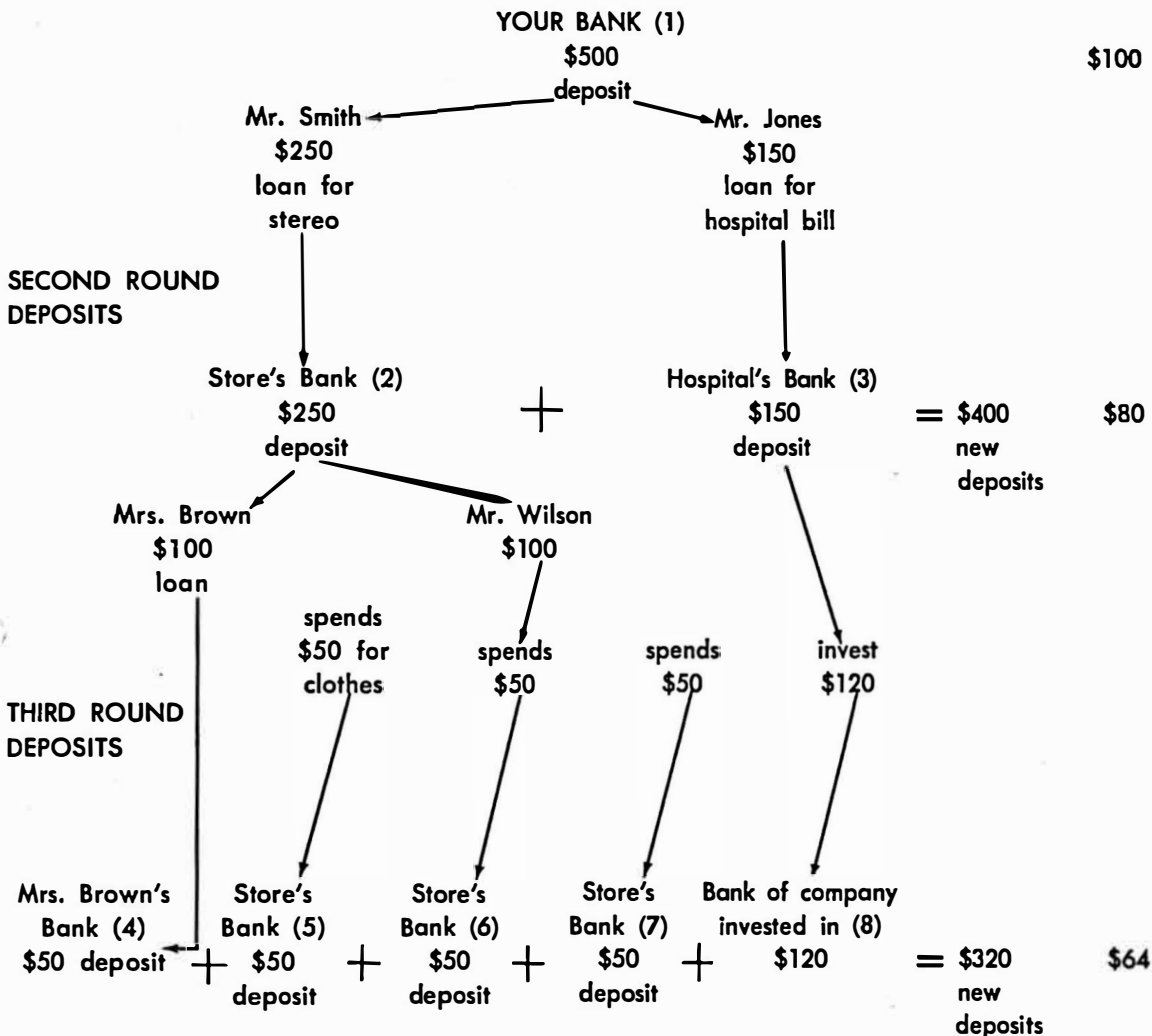
Your bank loans \$150 to Mr. Jones and \$250 to Mr. Smith. Mr. Jones pays a \$150 hospital bill. The hospital deposits the \$150 at its bank. Mr. Smith uses his \$250 to buy a stereo record player. The store deposits the \$250 at its bank. This means that \$400 worth of new deposits have been created by the commercial banking system. Remember that your original \$500 is still on deposit with bank 1. In addition to that, the \$400 that bank 1 was able to loan because of your deposit has been deposited in banks 2 and 3. There is now a total of \$900 worth of deposits based on your \$500.

Banks 2 and 3 are required to keep only 20 percent of these new deposits as part of their reserve and may loan the rest. This gives banks 2 and 3 a total of \$320 to loan. Bank 2 lends Mrs. Brown \$100. She

**TABLE 1. HOW COMMERCIAL BANKS CREATE MONEY**

20% RESERVE

**FIRST ROUND  
DEPOSITS**



deposits \$50 in her bank and spends \$50 at a clothing store. The clothing store deposits her \$50 as part of its daily receipts. Bank 2 also lends Mr. Wilson \$100. Mr. Wilson spends all of his money. This money is also deposited by the stores where he made his various purchases.

Bank 3 does not loan its money to an individual consumer. Instead, it loans money to a company which needs money to expand. The company deposits the money it receives in its own bank. The total amount of new deposits created in banks 4, 5, 6, 7, and 8 is \$320. The process will not stop here.

**TABLE 2. HOW COMMERCIAL BANKS CREATE MONEY**

New Deposits	Loans & Investments	20% Legal Reserve
\$500		\$100
	\$400	
\$400		\$80
	\$320	
\$320		\$64
	\$256	
\$256		\$51.20
	\$204.80	
\$204.80		\$40.96
	\$163.84	
\$163.84		\$32.77
	\$131.07	
\$131.07		\$26.21
	\$104.86	
\$104.86		\$20.97
	\$83.89	
\$83.89		\$16.78
	\$67.11	
<u>\$2231.57</u>	<u>\$1731.57</u>	<u>\$432.89</u>

Your original deposit of \$500 has been turned into \$2231.57 in check money by the operations of the commercial banking system. If this problem were carried as far as it would go, new deposits would be  $1.00/.20 \times \$500 = \$2500$ . The legal reserves would be \$500, the same amount as the first new deposit. Loans and investments would be  $\$2,500 - \$500 = \$2,000$ .

If you will study Table 2, you will see that much more business will take place because of your \$500 deposit. Find "New Deposits" of \$500, and "Legal Reserves" of \$100 on Table 2. From there you will be able to trace the creation

of money from your \$500 through the ninth round of deposits.

In almost the same way that banks can create new money by creating new demand deposits, they can destroy money by doing away with these demand deposits.

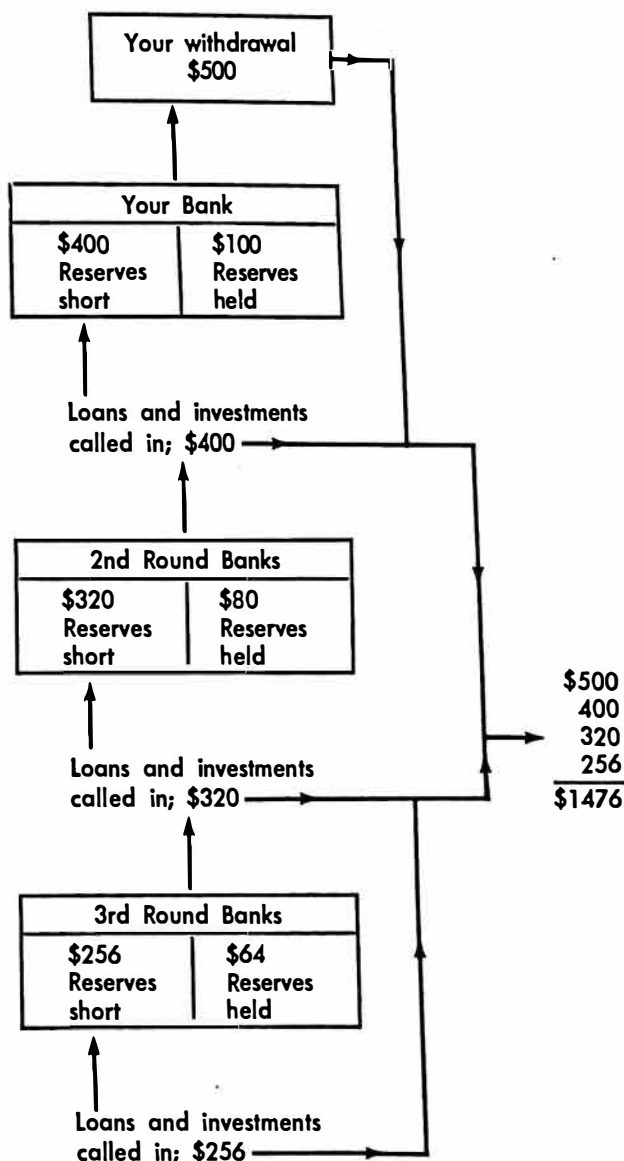
Money is destroyed, or taken out of circulation, when commercial banks are forced to call in their loans. This will happen if the banks' legal reserves become too low. Table 3 will show you how this can happen.

You decide to withdraw your \$500 from your bank. Remember that your bank held only 20 percent of your deposit. It held only \$100 in its cash reserve for your \$500 deposit. To pay you the full \$500, your bank will have to give you \$400 extra out of its cash reserve. This will mean that its cash reserve will now be short \$400. It will be well below the 20 percent legal reserve requirement. Your bank will have to call in loans to make up the \$400 difference that was created.

Banks throughout the commercial banking system will feel the effect of this. The effect will be exactly the reverse of what happened when your bank originally loaned your \$400. Compare Table 3 with Table 2. You will see how money was first created and then destroyed by the commercial banking system.

As you can see, the power of the commercial banks is great. Their ability to create and destroy money affects the economy of the entire nation. Further, no commercial bank can act without involving many other banks. For these reasons most of the commercial banks are supervised by the *Federal Reserve System*.

TABLE 3. HOW MONEY IS KILLED



Your withdrawal of \$500 has removed \$1476 from the cash deposits of the commercial banking system. If this problem were carried out as far as possible, deposits would be reduced by  $1.00/.20 \times \$500 = \$2500$ . The legal reserves would be reduced by \$500, the same amount as your original deposit. The loans and investments would be reduced by  $\$2500 - \$500 = \$2000$ .

### What is the Federal Reserve System?

The Federal Reserve System is the central banking system of the United States. Actions taken by the Federal Reserve System affect the thousands of commercial banks all over the country. The Federal Reserve System is not owned by the government. It is owned by the commercial banks that are the members of the System.

The System itself is made up of twelve Federal Reserve Banks. Each of the twelve Federal Reserve Banks is located in a different Federal Reserve district. The twelve districts cover the entire United States.

The twelve Federal Reserve Banks are each managed by the member banks in their districts. In turn, member banks are subject to general supervision and

examination by the Federal Reserve System. The System as a whole is supervised by the United States Government. The government supervises the System through the *Board of Governors*. The Board of Governors of the Federal Reserve System is made up of seven members. They are appointed by the President of the United States, and approved by the U.S. Senate.

Each member of the Board of Governors is appointed for a term of fourteen years. The terms of the members are arranged so that one term expires every two years. This is done so that there will always be experienced men on the Board. The Board of Governors is very important. Its suggestions affect not only the banking system, but also the entire economy of the United States.



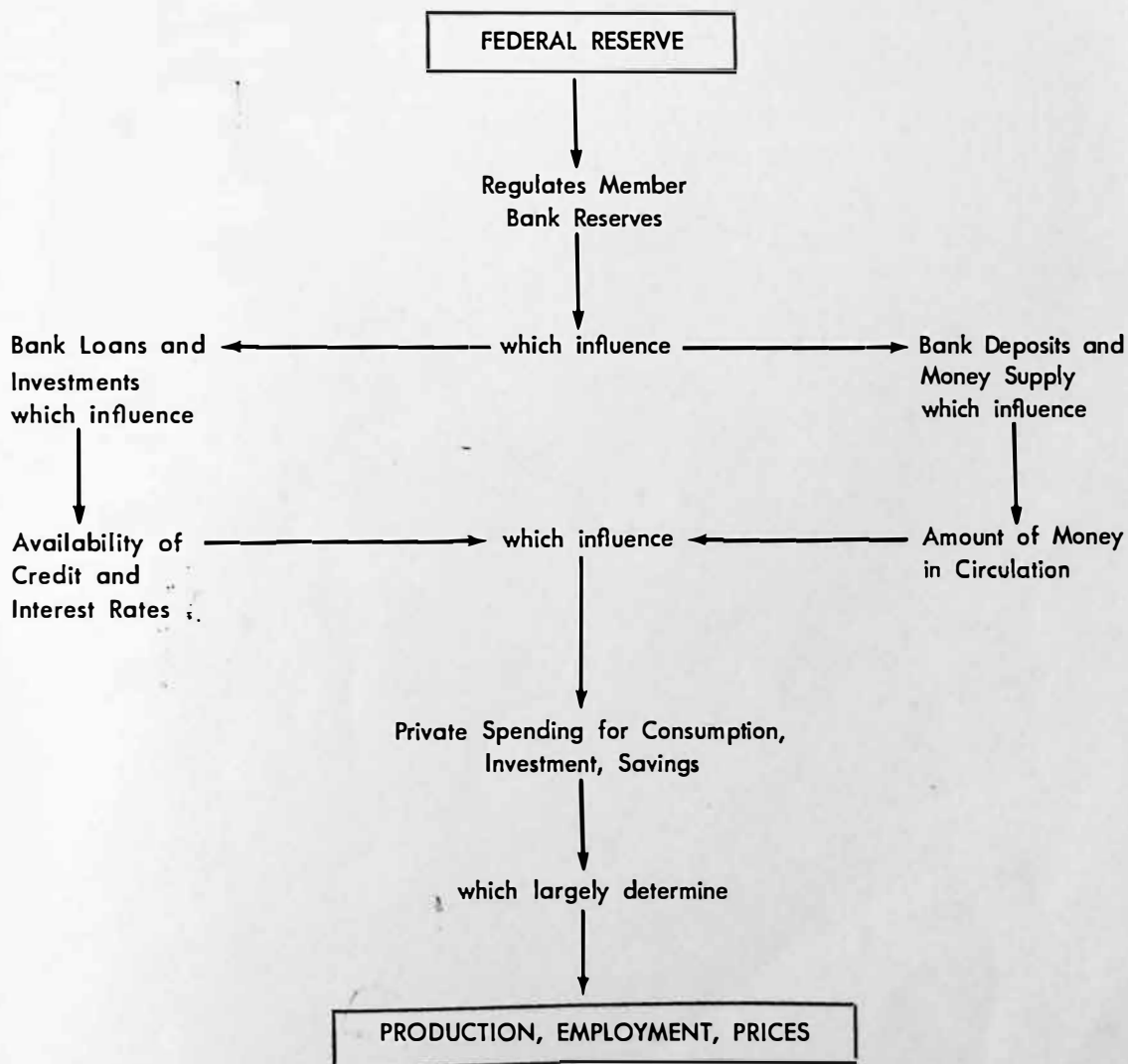
**What does the Federal Reserve System do?**

Federal Reserve Banks are not like ordinary commercial banks or savings banks. They do not accept deposits from individuals. They do not make loans to businessmen and consumers. Federal Reserve Banks are bankers' banks.

Most of the deposits made with Federal Reserve Banks are made

by commercial banks. The commercial banks deposit their cash reserves with their district Federal Reserve Bank. The Board of Governors sets the amount that the commercial banks must hold as a cash reserve. This amount can vary. Usually, the commercial banks must keep between 18 and 20 percent of their deposits in cash reserves.

**TABLE 4. HOW THE FEDERAL RESERVE SYSTEM INFLUENCES THE ECONOMY**



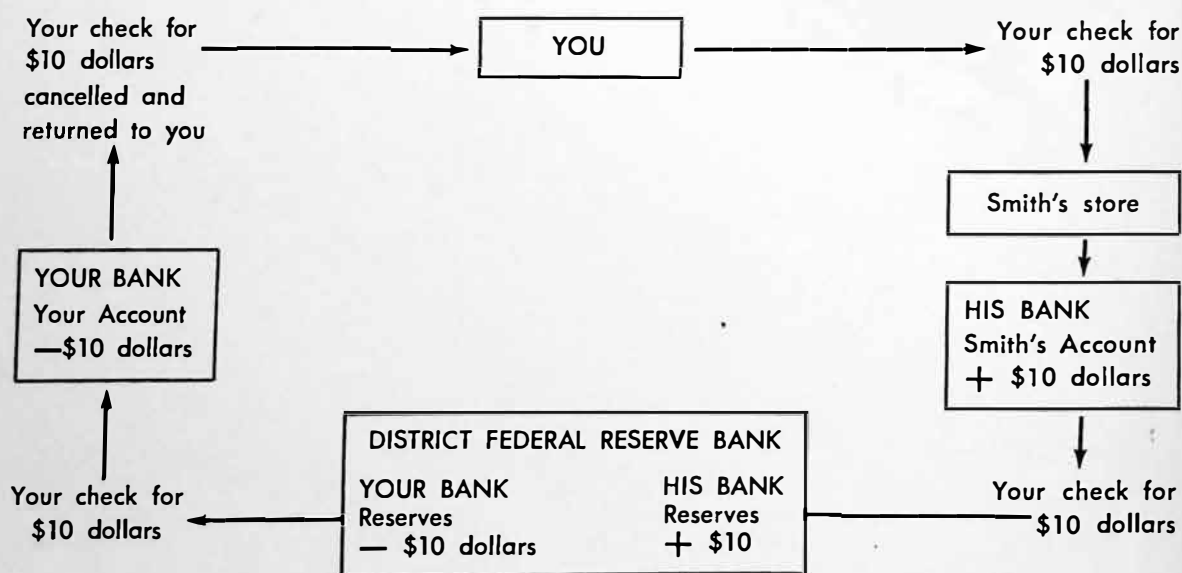
The Federal Reserve Banks also lend money to member banks. These loans are called *discounts*. Commercial banks borrow from the Federal Reserve when they wish to increase their reserves. As you saw earlier, increases in their reserves will permit commercial banks to create more money in the form of new demand deposits. The interest rate which the Federal Reserve charges member banks for loans is called the *discount rate*. The powers to set the reserve requirement and the discount rate are two of the most important powers of the Board of Governors. In Chapter 6 you will see how these powers are used to help regulate the economy.

The Federal Reserve Banks also accept deposits from the federal government. The income of many of the government's departments is deposited in the Federal Reserve

Banks. The Federal Reserve System helps the U.S. Treasury in a number of ways. The twelve Federal Reserve Banks issue legal tender in the form of Federal Reserve Notes. Commercial banks send old and worn paper money to the Federal Reserve Banks to be destroyed.

Finally, the Federal Reserve Banks act as the *clearinghouse* for the many checks of the member banks. This means that all checks pass through the Federal Reserve Bank and are returned to the check writer's bank. Table 5 will show you how this happens. Suppose that you buy ten dollars worth of clothing from Mr. Smith's store. You pay him with a check written against your account at Your Bank. He deposits your check at His Bank. How does the cash that you owe him get from Your Bank to His Bank?

TABLE 5. HOW A CHECK IS CLEARED AND PAID



First, His Bank sends the check to the local Federal Reserve Bank for *collection*. A check is collected when it is changed into legal tender. It is then stamped and cancelled to show the money has been paid. It cannot be used again after cancellation.

The Federal Reserve Bank subtracts the amount of your check from the cash reserves of Your Bank. It adds this amount to the cash reserves of His Bank. The check is sent to Your Bank. The amount of the check is subtracted from your account, and the cancelled check is returned to you.

This process is repeated billions of times every year. Because so many checks are used each year, new ways to handle them have been developed. Each checking account and commercial bank in the country has its own identification number. These numbers are printed on checks. Magnetic inks are used to print the numbers. When the checks reach the banks they are sorted at very high speed by machines which "read" the magnetic numbers. Machines then automatically charge the checks against the right accounts at the right banks.

The marks on this check show that it has been cashed and now must be cleared through the central check clearinghouse.



Without the aid of the Federal Reserve Banks acting as the central clearinghouse for checks, our whole system of check money could not exist. Do you think that this statement is true or false? Why do you think it is true? Why do you think it is false?

The importance of the system of check money which the activities of the Federal Reserve System make possible is difficult to imagine. The use of check money is a great convenience. It makes the use of bulky cash unnecessary. It permits our supply of money to be more flexible than it would be if only cash and coin were used.

As has already been stated, the use of check money is safer than the use of cash and coin. This is especially true when money is to be sent through the mail. The Federal Reserve's control over check money is important.

The Reserve System is needed for our financial system. It organizes and polices the activities of our banks. It is responsible for our paper cash. It makes possible the exchange of check money. It cooperates closely with the federal government in all financial operations. The Federal Reserve System is the very backbone of American finance.

This is the headquarters of the Federal Reserve in Washington, D. C. From here come decisions which affect our whole banking system.



## HOW BANKING BEGAN

Document 1: How did the modern commercial banking system develop into what it is today? How did it discover that it had the power to create money? In his book *Economics: An Introductory Analysis*, the famous economist Dr. Paul A. Samuelson gives his explanation of how modern banking may have come about.



Commercial banking is usually assumed to have begun with the ancient goldsmiths who developed the practice of storing people's gold and valuables for safekeeping. At first such establishments were simply like parcel checkrooms .... The depositor left his gold for safekeeping, was given a receipt, later presented that receipt, paid a small fee...and got back his gold.

Quite obviously...money is wanted for what it will buy, not for its own sake. Money has an anonymous quality, so that one dollar is just as good as another, and one piece of pure gold as good as another. The goldsmiths soon found it more convenient *not* to have to tag the gold belonging to any one individual so as to be able to give him... exactly the same piece of gold that he had left. Instead, the customer was...willing to accept a receipt for an amount of gold or money *of a given value*, even though it was not the identical particle of matter that he actually left.

This "anonymity" is important...If I check my bag at Grand Central Station and later see someone walking down the street with that same suitcase, there is nothing for me to do but call my lawyer and sue the railroad company. If I mark my initials on a \$10 bill, deposit it in my bank account, and later notice it in the hands of a stranger, I have no grievance against the bank management. They have only agreed to pay me on demand any old \$10 of legal tender.

But let us return to the goldsmith establishments...We have assumed that the company has long since dropped its activities as a smith and is...occupied with storing people's money for safekeeping. Over past time, 1 million dollars has been deposited in its vaults, and this whole sum it holds as a cash asset...

At this primitive stage, the bank would be of no...interest to the economist... (It would be) neither adding nor subtracting from total money.

(But if the goldsmith-banker) were an alert fellow, he would soon notice that, although his deposits are payable on demand, they are not all withdrawn together. He would soon learn that, although 100 percent reserves are necessary if the bank is to be liquidated...such reserves are not at all

necessary if his bank is a "going concern." New deposits tend to balance withdrawals. Only a little till money, perhaps less than 2 per cent, normally seems needed in the form of vault cash.

At first he probably thought this discovery to be too good to be true. Then perhaps he recalled the story of a rival bank whose dishonest clerk ran off with 95 per cent of its cash reserve—which was never discovered for 50 years. No one ever had occasion to go to the back rooms of the vault because all withdrawals were financed by recently deposited money held in the front vaults.

We can imagine our intelligent banker—at first cautiously—beginning to acquire bonds and other earning assets with some of the cash entrusted to his care. Everything works out all right: depositors are still paid off on demand, and the bank has made some extra earnings. Gradually the banker no longer feels it necessary to conceal from his depositors what he is doing. If a depositor complains, the banker retorts, "Your money is safe. If you don't like my way of doing business, you are at liberty to withdraw your funds. Besides, haven't you noticed that the new method of fractional cash reserves has enabled me to lower my service charges to you? Also, it has enabled me to give a helping hand to our local businessmen who need more capital to buy new tools, buildings, and inventories..."

Little wonder, therefore, that all banks should have begun to invest most of the money deposited with them in earning assets and to keep only fractional cash reserves against deposits. Indeed, as long as business confidence remains high, and provided the managers of the bank are judicious in their choice of loans and investments, *there is no reason why the bank should keep much more than 2 per cent cash reserves against deposits.*

From Economics, An Introductory Analysis, by Paul A. Samuelson. Copyright 1961, McGraw-Hill Book Company. Used with permission of the McGraw-Hill Book Company.

## Using Economic Methods

1. Examine the map of the Federal Reserve System. In which Federal Reserve district is your home located? What is the Federal Reserve Bank city of your Federal Reserve district? Are there more Federal Reserve districts on the east coast or on the west coast? Do the boundaries of the Federal Reserve districts always fall along the boundaries of states?
2. Study the reading from the book by Dr. Samuelson. How much cash does he think that a commercial bank should keep as a reserve? About how much does the Federal Reserve System demand as a reserve requirement? Why do you think that Dr. Samuelson feels the reserve requirement is higher than need be? Why should the reserve requirement remain

high? As you answer this question, keep in mind what the reserve requirement means for commercial banks.

3. At what point did the goldsmith shop become a commercial bank? What convinced the goldsmith that he could invest his depositors' money safely?

ˈɛk-ə-ˈnäm-iks

### Knowing Your Vocabulary

*time deposit* /ˈtɪm di-ˈpāz-ət/  
A bank account that is restricted as to the withdrawal of funds. Most banks require a written notice of withdrawal before money can be released from a time deposit. 83

*certificate of deposit*  
/ˌsər-ˈtɪf-i-kət əv di-ˈpāz-ət/  
A form of time deposit. Money cannot be withdrawn before the end of a certain time period. 83

*stop payment order*  
/ˈstɒp ˈpā-mənt ˈɔrd-ər/  
A written order to a bank authorizing them to refuse to pay money on a specific check. 84

*principal* /ˈprɪn(t)-s(ə-)pəl/  
A sum of money that is borrowed or saved. 86

*commercial year*  
/kə-ˈmər-shəl ˈyi(ə)r/  
A length of time which is used by banks and businesses for the sake of convenience. The commercial year consists of 360 days instead of 365 days. 86

*compound interest*  
/ˈkäm-paund ˈin-trəst/  
Interest figured on the amount of the original deposit, plus the accumulated interest which has already been earned. 87

*collateral* /kə-ˈlat-ə-rəl/  
Something of value given by a debtor to a creditor as security for a loan. 88

*mortgage* /ˈmɔr-gij/  
A temporary claim placed upon the title or deed to a home. 88

*short-term loan* /ˈshɔ(ə)rt ˈtɜrm ˈlɒn/  
A loan which must be repaid within a year or less. 89

*commercial loan*  
/kə-ˈmər-shəl ˈlɒn/  
A loan which is made to a business rather than to an individual consumer. 89

*self-liquidating loan*  
/ˈsel-flɪk-wə-dāt-ɪŋ ˈlɒn/  
A loan in which the borrowed funds are used to buy goods which

are meant to be resold at a profit. Part of the money for which the goods are resold will be used to pay off the loan. Money left over is profit. 89

*promissory note*

/ˈpräm-ə, sōr-ē ˈnōt/

A borrower's written promise to repay a loan, plus interest, on a specified due date. 89

*secured loan*

/si-ˈkyū(ə)rd ˈlōn/

A loan for which collateral has been given. 89

*unsecured loan*

/,ən-si-ˈkyū(ə)rd ˈlōn/

A loan for which no collateral has been given. 89

*legal reserve* /ˈlē-gəl ri-ˈzərv/

The amount of money that a commercial bank must hold as a cash reserve. This amount is a percentage of the bank's total deposits. 90

*discount* /ˈdis-kaunt/

Loans from the Federal Reserve System to its member banks. 96

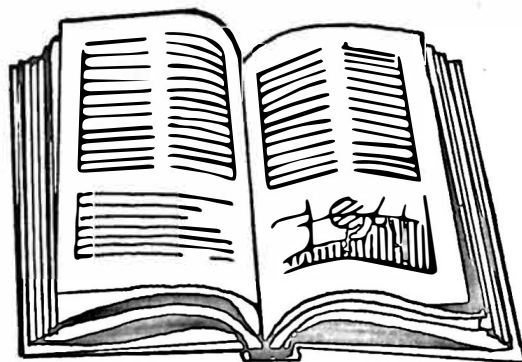
*discount rate*

/ˈdis-kaunt ˈrāt/

The interest rate which the Federal Reserve charges member banks for loans. 96

*collection* /kə-ˈlek-shən/

The process of obtaining legal tender for check money. 97

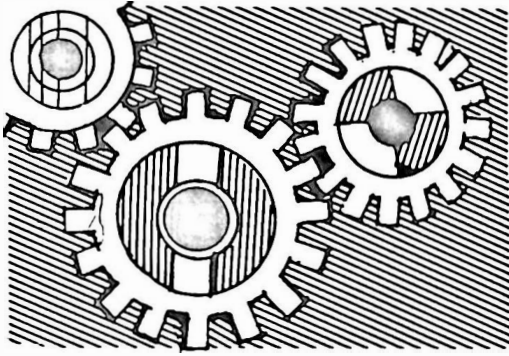


## Reading the Text

1. What reasons might convince a consumer to deposit his money in a bank?
2. What is a time deposit?
3. What are the purposes of the Federal Reserve System?
4. Name five different financial institutions in our economy.
5. What are the differences between commercial banks and the other financial institutions in our economy?

## Identifying Names and Terms

Federal Reserve Bank  
Member banks  
Board of Governors  
Federal Deposit Insurance  
Corporation  
F.S.L.I.C.



### Debating and Discussing Ideas

1. Which do you think is the most important financial institution in our economy? Give reasons to support your answer.
2. Do you think that our economy could exist in the form that it does without our system of financial institutions? If so, why? If not, why not?
3. How important, do you think, is the Federal Reserve system to our commercial banking system? What does the Federal Reserve do that is so important to commercial banking?
4. Why, do you think, do financial institutions require that consumers borrowing money from them give collateral for the loan? What might happen if financial institutions did not require collateral?
5. When commercial banks create money, what are they doing? Try to explain to a classmate how commercial banks create and destroy money.

### Reading Other Sources

Britton, V. *Personal Finance*. New York: American, 1968.

Bryant, W. *Mortgage Lending*. New York: Mc Graw-Hill, 1964.

Cobleigh, I. V. *How and Where to Borrow Money*. New York: Hearst, 1965.

Unger, M. and H. Wolf. *Personal Finance*. New York: Allyn and Bacon, 1964.

Wade, William W. *From Barter to Banking*. New York: Crowell-Collier, 1967.

#### Solutions to the problems:

Problem 3 (page 86): \$.10

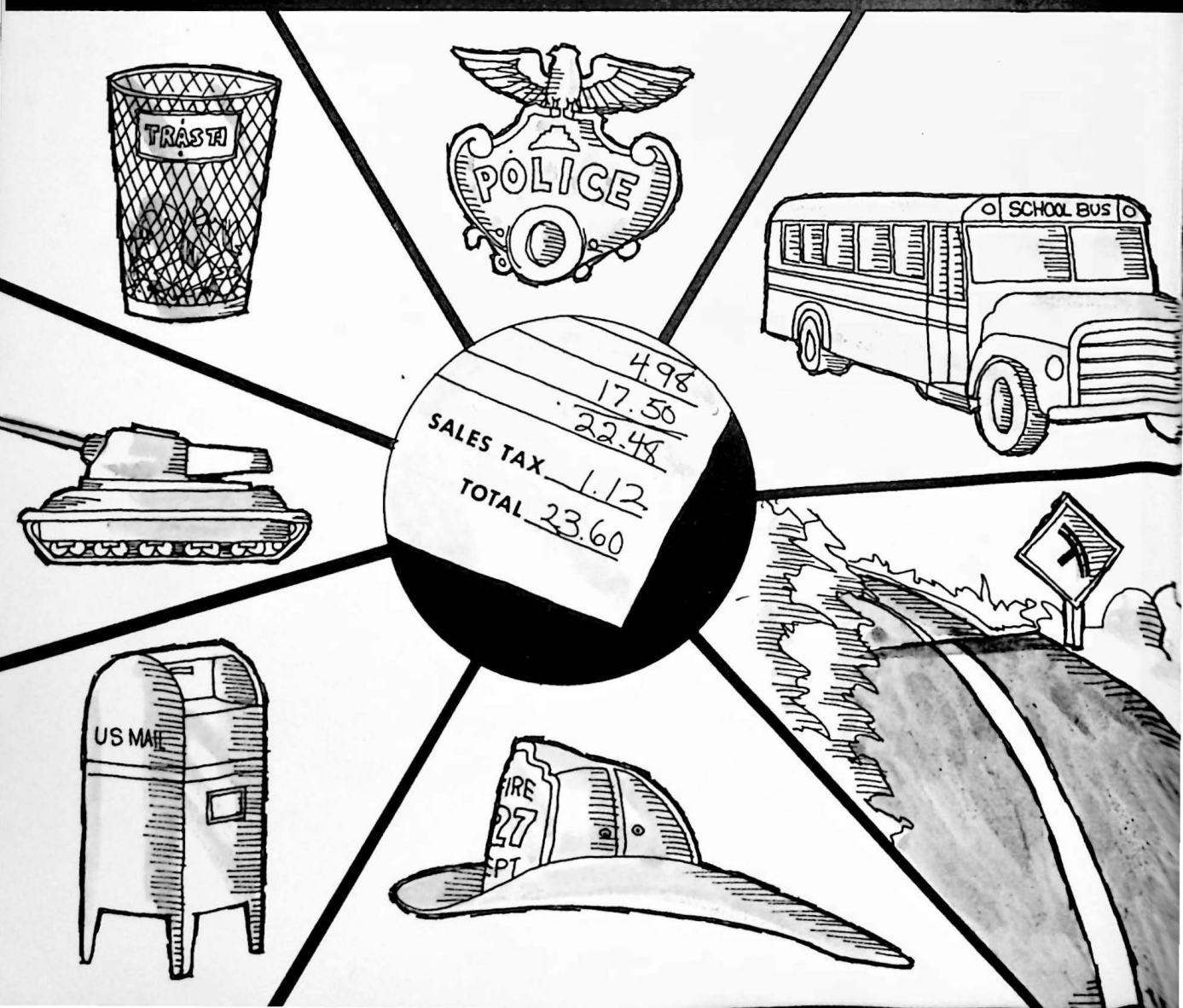
Problem 3 (page 87):

1st year	\$15.00
2nd year	15.75
3rd year	16.54
<u>total</u>	<u>\$47.29</u>

## 6. The Government and Economics

*The expansion of governmental functions has been furthered by a changing attitude of the public toward the use of government to provide security against many economic risks.*

Marshall Robinson, et.al.  
An Introduction to Economic Reasoning



**Who is the largest buyer of goods and services in the nation?**

You live in a *free-enterprise* economy. This means that producers, sellers, and consumers are free to make their own economic decisions. There is very little direct regulation by the federal, state, and local governments. But this does not mean that your governments do not affect the economy. They do. Your governments affect the economy because they are the largest buyers of goods and services in the nation.

This was not always true. Before 1900 federal, state, and local governments spent very little money. One reason for this was the fact that the nation produced fewer goods and services than it does today. A second reason was that governments were responsible for much less than they are today. But beginning with the year 1914, expenses of government, especially those of the federal government, began to rise.

There were many reasons for this. The goods and services were growing more costly. Citizens began demanding more and more services from their governments. Governments were becoming responsible for the purchase of more goods and services.

Government expenses have continued their increase up to the present day. While expenses of state and local governments have risen steadily over the years, the expenses of the federal government

have taken large jumps. If you will study the graph on page 106 showing the expenses of government since 1900, you will see in what years this happened.

The great increase in federal expenses started at the time of the Second World War. This was due mainly to the costs of fighting the war, and the continuing costs of defense since the war. Even today, over one-half of the federal budget every year goes to pay for our past wars and today's defense programs.

However, defense is not the only expense. Graph 1 also shows how much the total expenses of government have grown since 1900. The importance of these expenses can be seen from the following information. By the late 1960's, one out of every seven workers in the United States worked for the government. Over one-fifth of the money paid for wages in the United States was paid by the government. Over 20 percent of all goods and services produced yearly was being purchased by the government. Clearly, government has become the largest single buyer of goods and services in the nation.

**How does the government get its money?**

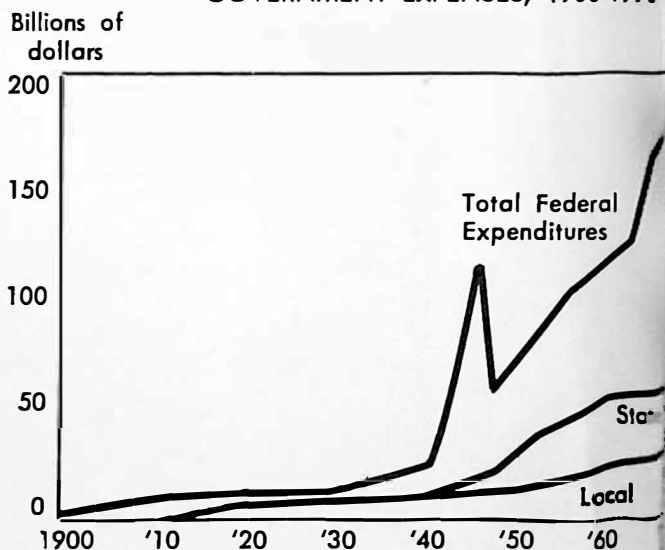
You can see that the government spends a great deal of money. How does the government get this money? Does it create money out of thin air? Does it just print more money as it needs it? The answer

to all these questions is "no." Just as you are faced with the problem of satisfying your unlimited wants with limited resources, so is the government. There are many things the government would like to do. It would like to clean up air and water pollution. It would like to replace the slums of the cities with decent housing. It would like to conquer outer space. It would like to lower taxes. But it cannot do all these things. Government's wants are limited by its needs and the size of its income.

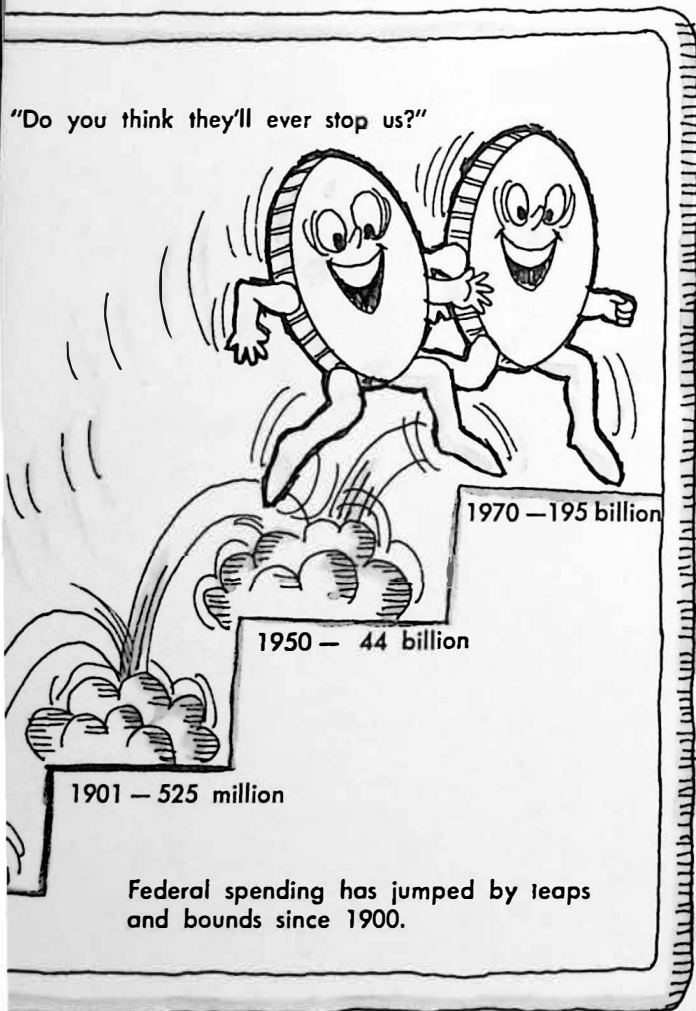
The government's source of funds is based on two things. The first is *taxation*. The second is borrowing. Taxes are money collected by the government and spent for public services. You may think of taxation as a wage that you pay to your government. In return for this wage your government works to provide you with things that you need, such as national security, and the things that you want, such as better roads and parks.

There are many different kinds of taxes. Some are federal taxes, some are state taxes, and some are local taxes. Look at the chart to see which of your governments collects which kinds of taxes. As you will notice, several of these taxes are collected by two, and some by all three, of your governments. You will have to pay some of these taxes. Some of these taxes will be paid by others.

**GRAPH 1. FEDERAL, STATE, AND LOCAL GOVERNMENT EXPENSES, 1900-1970**



Source: U.S. Bureau of the E.



## FEDERAL, STATE, AND LOCAL GOVERNMENTS COLLECT MANY DIFFERENT KINDS OF TAXES

### INCOME TAX

A tax paid by individuals on their incomes, and by corporations on their profits. This is the most important source of revenue for the federal government. Many state governments also collect an income tax.

### EXCISE TAX

A tax paid on telephone calls, business machines, railroad and plane fares, liquor, and cigarettes. Federal, state, and local governments use excise taxes as a source of revenue.



### TARIFFS OR CUSTOMS DUTIES

Taxes on goods bought outside of the United States and then imported into this country. The federal government collects these taxes.

### ESTATE TAX

Taxes paid on property inherited from a person who has died. Federal and state governments use this source of taxation.



### PROPERTY TAX

A tax paid on land and buildings. State and local governments rely heavily on the collection of property taxes.

### SALES TAX

A tax that is charged on the sale of items usually bought from a retail store. This is the largest source of income for state governments.



The single most important tax collected is the personal income tax. This is the one that will affect you the most. Everyone who earns at least \$1,725 per year is required to pay federal tax on his income. In addition to the federal income tax, many states and cities also collect separate income taxes from their citizens.

The amount that you will have to pay in income taxes depends on several things. In the first place, your income tax is a *progressive tax*. This means that the larger your income is, the larger the percentage of your income you will have to pay in income taxes.

In the second place, the amount of your tax will depend on number and size of your *deductions*. Deductions are amounts allowed for certain things which may be subtracted from your income. You pay no income tax on deducted income. Study Table 1. It lists the most common deductions and shows what their effects might be on the amount paid.

Governments do not expect you to pay the whole amount of your income tax at one time. Instead, most of your income tax is paid through the *withholding system*. This means that every time that you are paid your wages by your

The standard deduction is the maximum amount that may be used without proof. If you exceed this amount, you must have receipts to prove it.

**TABLE 1. YOUR INCOME TAX AND WHAT IT COSTS YOU**

Using Standard Deductions		Using Itemized Deductions	
Your income:	\$10,000	Your income:	\$10,000
(Single person, no dependents)		(Married, with 2 children)	
Approximate federal income tax	\$1,725	\$650 exemption allowed for each dependent	—2,600
		Contributions to charity	—400
		Interest paid on installment contracts and loans	—300
		Sales tax, state income tax, gasoline tax, personal property tax	—500
		Total deductions and exemptions	3,800
		Your taxable income	\$6,200
		Approximate federal income tax	\$1,038

employer, a small amount of money is held out of your check. This money is deposited with the government. At the end of the year, the money that was withheld is used to pay your income taxes. If the amount of your tax is greater than the amount withheld, you will have to pay the difference to the government. If the amount of your tax is smaller than the amount withheld, the government will pay the difference back to you as a refund.

Many state governments depend upon the sales tax as their most important means of getting money. If you live in a state that has a sales tax, then you pay this tax on many things that you buy. The amount of the sales tax varies from state to state. In some states it is as low as 2 percent. In other states it is as high as 6 percent. This means that if you bought an article for \$1.00, it could cost you anywhere from \$1.02 to \$1.06. The price would depend upon the sales tax rate charged in the state where you bought the item. What rate is the tax in your state?

City and local governments often collect their own sales taxes. This adds even more to the purchase price of goods and services. Sales taxes are considered to be *regressive taxes*. This means that as your income increases, you pay a smaller and smaller percentage of your income for this tax. Table 2 shows the way in which the sales tax becomes a regressive tax.

Governments get part of their money by borrowing. This borrowing may be done directly from banks or other financial institutions. Or it may be done through the sale of *bonds*. A bond is a certificate which represents a loan of money. Bondholders receive interest for the use of their money. Government bonds are the debts of the government. People who buy bonds become the creditors of the government.

Many different kinds of bonds are offered for sale by state, local, and federal governments. Many of these bonds sell for very large

Even though Mr. Smith makes more money, spends more money, and saves more money than Mr. Jones, Mr. Smith pays a smaller percentage of his income in sales tax than does Mr. Jones. The sales tax has a much greater effect on Mr. Jones' income than it does on Mr. Smith's. Mr. Smith pays a smaller percentage because he can avoid paying sales tax on \$4000 of his income by saving it. Mr. Jones is not so lucky. He spends most of his income for necessities.

TABLE 2. THE SALES TAX: A REGRESSIVE TAX

	Mr. Smith	Mr. Jones
Income:	\$10,000	\$5000
Saved:	\$4000	\$1000
Spent:	\$6000	\$4000
Amount of sales tax @ 3%	\$180	\$120
Percent of income paid in sales tax	1.8%	2.4%

109

amounts of money. They are purchased by businesses, banks, and even other governments. Some of these bonds can be bought by you. One type is the United States Savings Bond. Whenever you buy a savings bond for yourself or as a gift for someone else, you are loaning your money to the federal government. The increase in the value of the bond represents the interest that the government pays you for their use of your money.

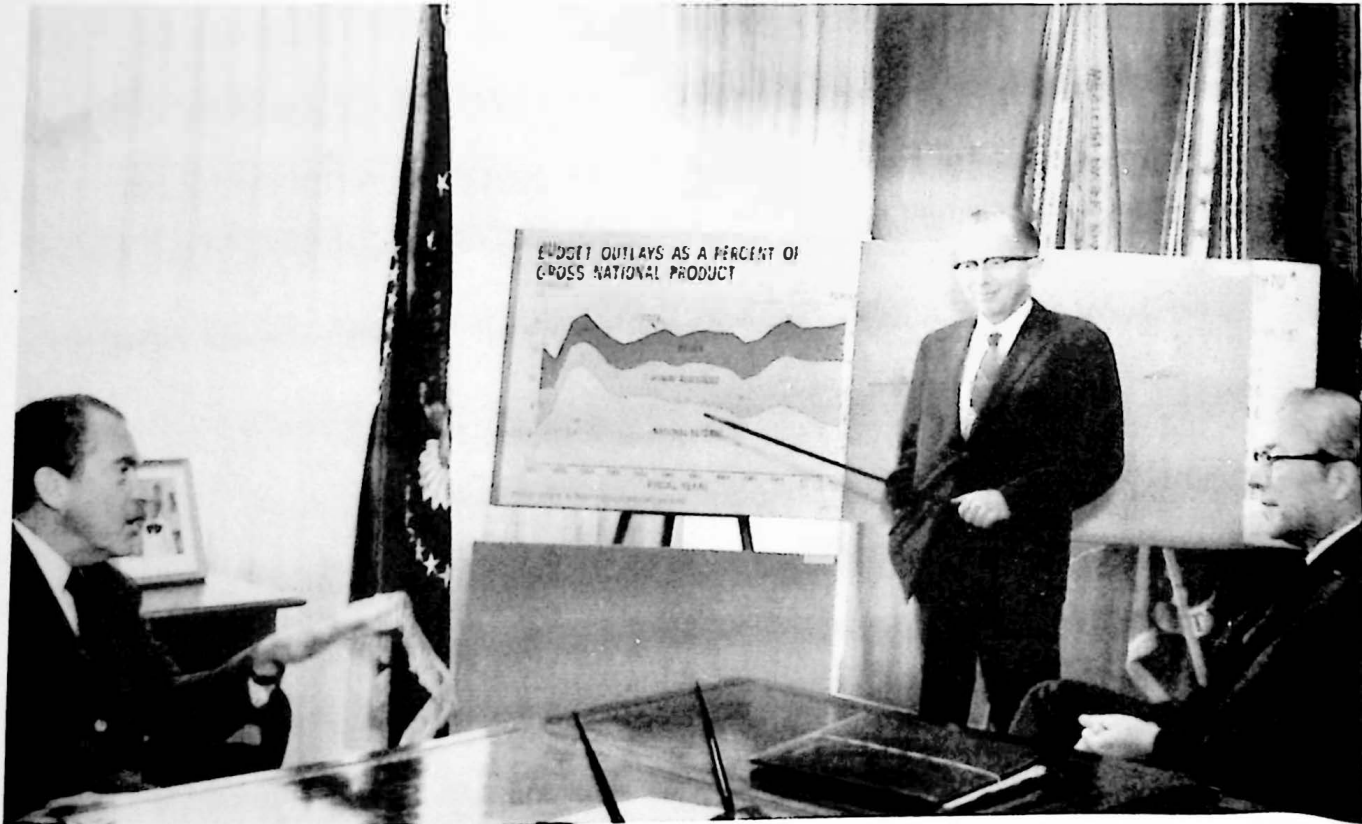
These are some of the more important ways that the government gets its money. But how does it spend the money? Federal, state, and local governments are re-

sponsible for a great many services. They must spend a great deal of money to meet these responsibilities. They choose carefully how to spend the money they have.

#### **How does the government spend its money?**

Chapter 3 brought out the importance of making a budget and a spending plan. It explained how budgets and spending plans could help keep your spending within your income. Use of a spending plan can help you satisfy many of your wants and needs. This could be done through the careful use of your limited resources.

The preparation of a budget for the Federal government is the most difficult problem every president has to solve.



Governments know this. They also use economic tools such as budgets and spending plans for the same reasons that you do. All three levels of government have special departments of the budget. These departments spend all of their time trying to match the wants and needs of government to the limited resources of government. They make government budgets and government spending plans.

These budgets and spending plans are then presented to the legislatures. These elected representatives of the people have the

power either to approve or turn down government budgets. They may demand that money be shifted from one part of the budget to another. They may demand that government expenses be raised or cut. In any case, the budgets and spending plans cannot be put into effect until they have been approved by the legislatures.

Table 3 is an example of what the federal budget looked like for the year 1969. The table shows you where the federal government gets its money. It shows you how the government spends its money.

**TABLE 3. THE FEDERAL BUDGET, 1969**

Source of Income	Amount (billions of dollars)	Expenses	Amount (billions of dollars)
Income tax	\$91	National defense	\$80
Corporation tax	35	Space research	4
Payroll tax	32	Foreign aid	4
Excise tax	14	Agricultural aid	5
Estate tax	4	Conservation	1
Customs duties	3	Commerce and transportation	8
<b>TOTAL INCOME</b>	<b>\$179 billion</b>	Housing development	2
<b>EXPENSES</b> \$184 billion <b>INCOME</b> —179 billion <b>DEFICIT</b> \$ 5 billion  The deficit to be made up through government loans, sale of bonds, and so forth		Education	7
		Health and welfare	48
		Veteran's benefits	7
		General expenses	3
		Interest on the National Debt	15
		<b>TOTAL EXPENSES</b>	<b>\$184 billion</b>
All figures have been rounded off to the nearest billion.			

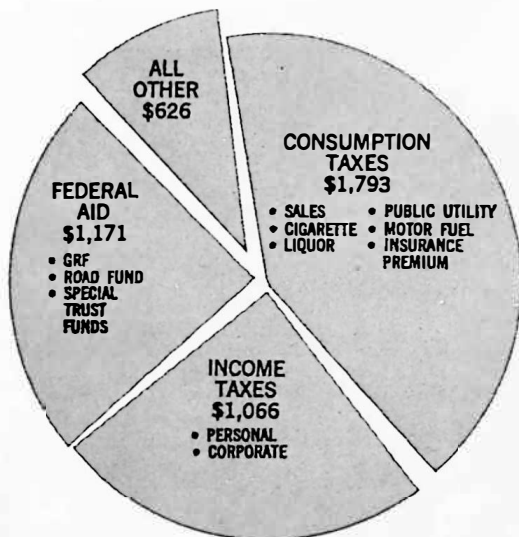
Source: U.S. Bureau of the Budget

**GRAPH 2. STATE OF ILLINOIS PROPOSED BUDGET**

**REVENUES AND APPROPRIATIONS**  
**ALL APPROPRIATED FUNDS**  
 Fiscal Year 1971—In Millions of Dollars

**WHERE THE MONEY COMES FROM:**

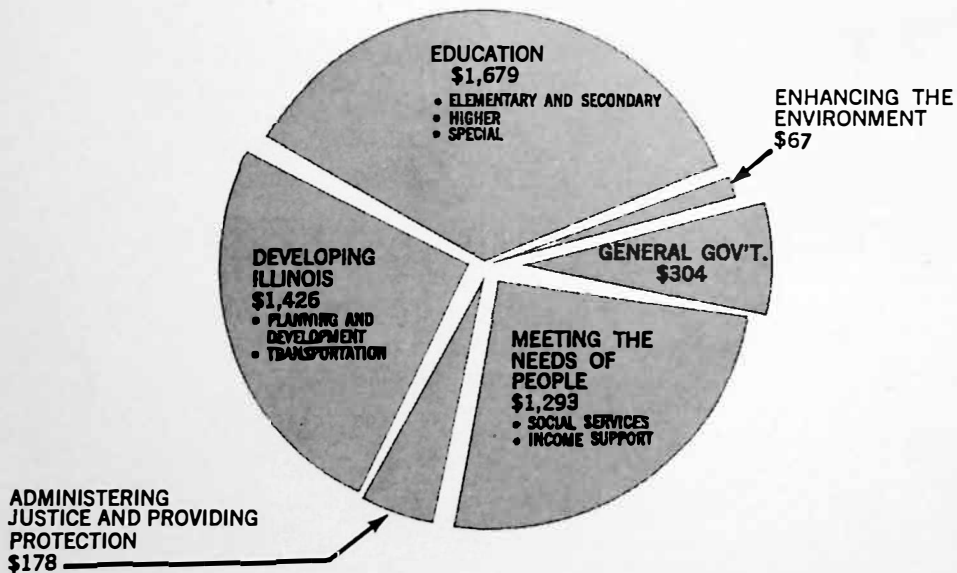
**TOTAL \$4,656\***



*\* Excludes beginning balance.*

**WHERE THE MONEY GOES:**

**TOTAL \$4,947**



Graph 2 shows a sample state budget, where the state gets its money, and on what the money is spent. The dollar total of all state and local government expenses usually runs from 70 to 80 billion dollars yearly. It is clear that organizations which control such great amounts of money must have an effect on the course of the entire economy.

What are the effects of government's economic activities?

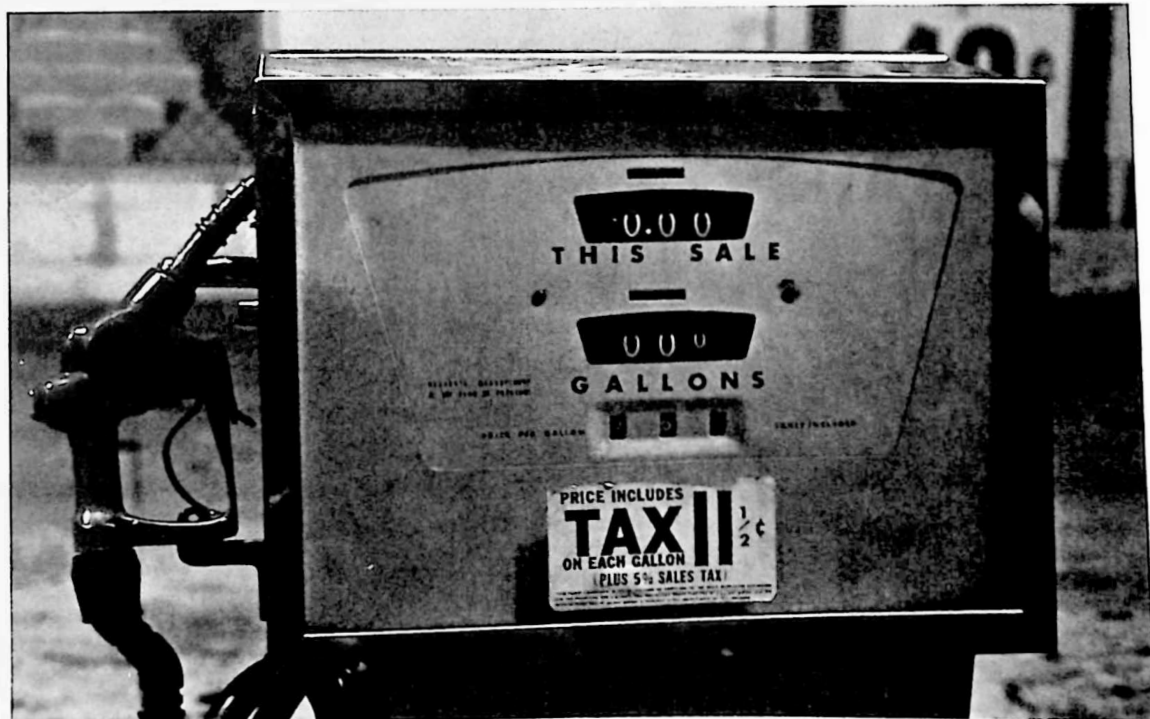
Federal, state, and local governments can affect the economy for many different reasons and in many different ways. Through their taxing powers, governments can regulate the amount of money consumers will have left to save

or to spend after they have paid their taxes.

Every time that governments raise their taxes, some money is no longer available for personal use. The effects of this can be very far-reaching. For example, think back to the tomato farmers in Chapter 2. By the law of supply and demand, the market price of tomatoes would be \$.30 a pound. At that price 400,000 pounds of tomatoes would be sold.

Study the graphs on page 36 again to see what effect a 6 percent sales tax will have on the sale of tomatoes. A 6 percent sales tax will raise all prices on the supply curve by 6 percent. These higher prices will cause consumers to buy fewer tomatoes than before.

The sales tax charged here helps to pay for many government-provided goods and services for your community.



**TABLE 4. HOW A TAX CAN AFFECT YOUR BUDGET**

Budget For A Week: Mr. and Mrs. Smith		
Income	Amount	Amount
Regular job	\$80.00	\$80.00
Weekend jobs	15.00	15.00
<b>TOTAL INCOME</b>	<u>\$95.00</u>	<u>\$95.00</u>
Expenses	Without 6% sales tax	With 6% sales tax
Regular expenses		
Groceries	\$15.00	\$15.90
Transportation (gasoline purchases)	4.00	4.24
Rent	20.00	20.00
Installment payment	4.00	4.00
Insurance payments (car and life)	4.00	4.00
Bond deduction (savings)	18.75	18.75
Miscellaneous	2.00	2.12
<b>Total regular expenses</b>	<u>\$67.75</u>	<u>\$69.01</u>
Occasional expenses		
Clothing	\$10.00	\$10.60
Recreation and entertainment	5.00	5.30
Newspapers, magazines, books	1.50	1.59
Cosmetics and personal items	3.50	3.71
Medical and dental care	4.00	4.00
Miscellaneous	2.00	2.12
<b>Total occasional expenses</b>	<u>\$26.00</u>	<u>\$27.32</u>
<b>TOTAL EXPENSES</b>	<b>\$93.75</b>	<b>\$96.33</b>
<b>SURPLUS OR DEFICIT</b> (subtract total expenses from total income)	<b>\$ 1.25</b> surplus	<b>\$ 1.33</b> deficit

What would the addition of a 6 percent sales tax do to a family's budget? Table 4 shows what the effects of this tax would be on a young married couple, Mr. and Mrs. Smith. Without a sales tax, their total expenses for a week are \$93.75. These expenses leave them with a cash surplus of \$1.25 a week. This means that they are living within their income.

With a 6 percent sales tax added to their total weekly expenses, the Smiths no longer have a surplus. They now have a deficit. They are no longer living within their income. Therefore, they will either have to cut their spending or cut their savings. They will be forced to consume and to save less to bring their spending back within their income.

This increase in the sales tax of 6 percent will affect much more than just the Smiths' budget. Multiply their decision to cut spending times the millions of individual consumers who would feel the result of this tax increase. What would happen to the amount of goods and services sold after the tax increase? Would the tax increase mean less production of goods and services? What would this mean to the income of the average workingman?

If governments can cut consumer spending by raising taxes, they can also increase consumer spending by lowering taxes. Even the smallest percentage increase or decrease in taxation may have great effects when multiplied by the millions of consumers in the United States. Through the power to tax, your governments can make far-reaching changes in the economic life of the nation.

Governments also affect prices and production because of their spending power. Table 3 on page 111 showed what great resources the federal government has for spending. The total expenses of all levels of government amounts to about \$250 billion a year. Most of this money is put into the economy. Some of this money affects production directly because of government purchases of goods and services. Some of the money is added to the economy through the wages paid government employees.

What the governments decide to spend their money on can cause changes in the whole economic structure. For example, suppose that your town government chooses to spend 8 percent instead of 10 percent of its budget on highway construction. The 2 percent saving is added to the police and fire department budgets. The results here will be far-reaching.

If governments raise expenses by raising salaries, services such as highway repair and public health may have to suffer.



More men may find jobs as policemen and firemen. Salaries of men already working for the departments may go up also. The stores where they shop for their goods and services will enjoy higher sales. The stores will increase their orders for goods. The suppliers and producers of these goods will find their sales increasing. The police and fire departments will be able to buy some new equipment. The companies that sell and produce this equipment will see their sales go up.

However, the companies that build and repair highways will see their profits drop. Their workers will receive lower wages. Stores where highway workers shop will have lower sales. Construction equipment producers might see their orders drop.

Through their decision to spend less in one part of their budget and more in another, government has caused many changes in the economy. Much more than highway construction and police and fire services have been affected.

**How does the government act to make the economy possible?**

Some of the earlier chapters explained things that are vital if we want a successful free enterprise economy. There must be an acceptable medium of exchange. Contracts must be honored. There must be a system of laws which protects both producers and consumers. There must be peaceful

ways to transfer buying power from those who have more than they need to those who need more than they have. There must be a system to protect the economic structure and the nation. There must be a means of communication and exchange between our economic structure and other economic structures of the world.

Governments make all of these things possible. Currency is issued by the United States Treasury or by the government-regulated Federal Reserve Banks. The Federal Reserve System regulates how much check money is in circulation. Many levels of government organize to apply our system of law and justice. This system guarantees and protects the freedom and the rights of the individual. It protects both the buyer and the seller in the economic market.

Governments also are responsible for national defense. They are responsible, within the nation, for law and order. Governments work with other nations and economic structures. This helps trade and exchange between different economic structures. Governments give us the framework of order and responsibility in which our economic system can operate.

**How does the government regulate the economy?**

Economic structures are not perfect. All systems have problems. If the structure is not perfect it may not be fair to some people.

When this happens, government is ready to step in to "smooth out the rough spots." You have already learned that the government can help expand certain areas of the economy through its spending policies. You have learned that government stands ready to protect the consumer with such laws as the Truth In Lending Act and Fair Packaging and Labeling Act.

In addition, government has set up many departments and bureaus to help it regulate the economy. There are too many departments to list them all, but Table 5 will show you some of the more important agencies.

You have also learned that the government can regulate the economy by controlling the amount of money in circulation. This is perhaps government's most important economic tool. It can do this

in three ways. It can control money through its taxing policies, as you have already seen. It can use wage and price controls as it did during World War II. Or it can control money through the Federal Reserve System.

**How is the Federal Reserve System used to regulate the economy?**

In Chapter 5 you learned about the importance of the Federal Reserve System to the financial life of the nation. But the Federal Reserve has powers that can affect much more than commercial banks. The policies of the Federal Reserve can affect you directly. This is because the Federal Reserve System controls the flow of money into and out of the economy. In this way, the Federal Reserve can help control the economy if that becomes necessary.

**TABLE 5. SOME GOVERNMENT REGULATORY AGENCIES**

Agency	Responsibilities
Interstate Commerce Commission (ICC)	Regulates railroad rates, routes, and services. Regulates buses traveling over state lines.
Federal Trade Commission (FTC)	Prevents unfair competition. Prevents false advertising. Prevents monopolies.
Federal Power Commission (FPC)	Regulates interstate commerce involving the sale of electricity and natural gas. Grants licenses for hydroelectric projects.
Federal Communications Commission (FCC)	Regulates interstate and foreign communication by wire and radio, including television. Grants licenses to broadcast.
Civil Aeronautics Board (CAB)	Regulates U.S. airlines. Promotes safety standards and investigates airplane accidents.

The Federal Reserve controls the money flow through its power over the reserves of its member banks. It can control reserves of commercial banks in several ways.

In the first place, the Board of Governors can raise or lower the reserve requirements of the member banks. Remember that the smaller the reserve requirement is, the more money the banks can create through loans. The larger the reserve requirement is, the less money can be created. If the reserve requirement is 20 percent, banks may loan or invest up to 80 percent of their deposits. If the reserve requirement is 30 percent, banks can loan or invest only 70 percent of their deposits.

Secondly, the Board of Governors can raise or lower the rate of discount. You will remember that this is the rate of interest which the Federal Reserve Banks charge their member banks for loans. Commercial banks borrow from the Federal Reserve in order to increase the size of their cash reserves. The larger the reserves of a bank are, the more money that bank can lend to consumers and businesses. The smaller a bank's reserves are, the fewer loans it will be able to make. If the discount rate is low, banks will be anxious to borrow to increase their reserves. If the discount rate is high, there will be less borrowing from the Federal Reserve, fewer bank loans to consumers, and less money will be created.

Thirdly, and most important, the Federal Reserve System can control money flow through its *open market operations*. Through its open market operations, the Federal Reserve buys and sells government bonds from or to commercial banks and the general public. Government bonds are the personal debts of the federal government. They are a safe way to earn interest on money.

The effects of the Federal Reserve's open market operations can be very great. Suppose that the Federal Reserve wishes to increase the amount of money in the economy. It simply begins to buy government bonds in large amounts. If it buys from commercial banks, the size of the banks' reserves will be increased directly. If it buys from private individuals, much of the money will be deposited in banks. These deposits will also increase the size of bank reserves. The increased reserves mean more money created in the form of demand deposits.

If the Federal Reserve wishes to decrease the flow of money into the economy, it sells large amounts of government bonds. These sales will have the effect of decreasing bank reserves. Commercial banks will simply transfer cash from their reserves to the Federal Reserve Bank to pay for the bonds. Individual buyers will pay for their bonds either by check or by straight cash withdrawals from their banks. In either case, the

amount of money in commercial bank reserves will fall. This means fewer new demand deposits and fewer bank loans.

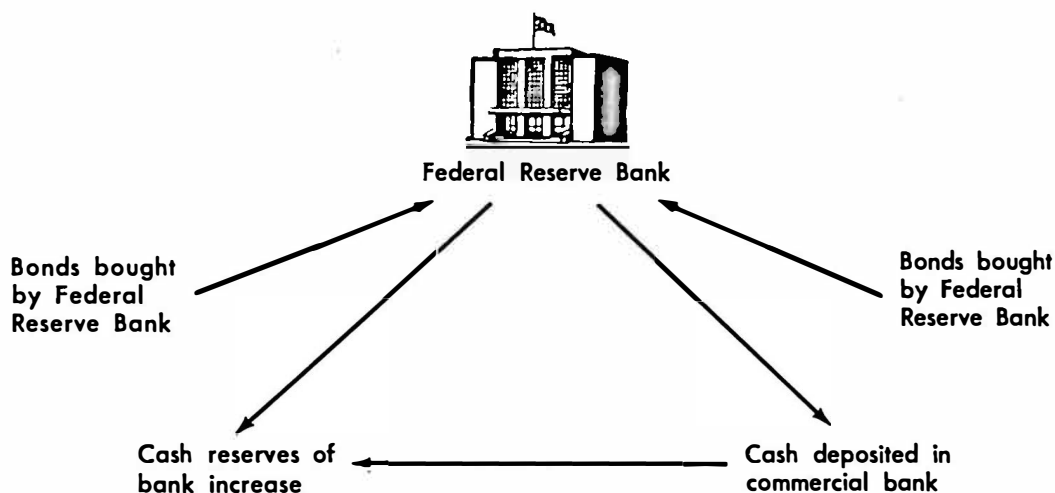
As we saw in Tables 1, 2, and 3 of Chapter 5, a small increase or decrease in the reserves of a commercial bank can cause a large increase or decrease in its deposits and loans. This means that by selling a small amount of government bonds in the open market, the Federal Reserve Banks can cause a large decrease in deposits and loans of commercial banks. By buying a small amount of government bonds in the open market, the Federal Reserve Banks can cause a large increase in deposits and loans of commercial banks.

**When does the Federal Reserve use its control powers?**

The Board of Governors of the Federal Reserve System does not act alone to change its money policy. It is aided by meetings with representatives of the President of the United States. It also receives advice from the *Federal Advisory Council*. This council is made up of twelve bankers, one from each of the twelve Federal Reserve districts. Members are elected yearly by representatives of the member commercial banks. The members of the Federal Advisory Council are in closer touch with the day-to-day condition of the economy than are the members of the Board of Governors.

### OPEN MARKET OPERATIONS

(Increasing Money in Circulation)



The Federal Reserve System may increase or decrease the amount of money in circulation by either purchase or sale of government bonds. If the process shown here is reversed, there will be less money in circulation.

If the Board of Governors is advised that business conditions are beginning to get bad, the Federal Reserve will allow its member banks to increase their reserves. It will do this by using all of the methods that you have already learned about. It will start in the open market with the purchase of bonds. It will lower the discount rate. It will lower legal reserve requirements if these means are not enough. This will allow more money to be loaned and to be put into circulation. With more money in circulation, consumers will probably begin buying more and, hopefully, business will improve.

If there is too much money in circulation, consumers will begin to buy too much. Prices will begin to rise. Soon, the cost of living for the average consumer will become a serious problem. Consumers will keep on buying, so prices will stay high. But they will begin to buy more carefully. This means that the demand for certain goods will begin to fall, while the demand for other goods will remain high and may even grow. The result will be growing unemployment in some industries. At the same time, the cost of living will continue to go up in the economy as a whole.

At this point, the Federal Reserve will step in and try to force a lowering of the cost of living. It will use all of its tools to lower the reserves of the member banks. This means fewer new demand deposits, and less money flowing into

the economy. Consumers will be forced to stop buying. This will cause business to cut production.

If everything works properly, the increases in the cost of living will probably level out. The cost of living even may go down. There will still be unemployment because of the decrease in production. But this unemployment may be only temporary. At this point, the Federal Reserve will allow money to begin flowing back into the economy. Prices will again begin to rise, production will increase, and unemployment will begin to decline.

This service which it performs for the Federal Government is the Federal Reserve System's main job. It must try to keep a balance between too much or too little money in circulation. This balance and the regulatory policies of the Federal Reserve System affect you directly because of their effect on prices and employment.

You have learned about some of the economic activities of government in this chapter. You have learned that government is an important part of the economy as a whole. You have learned that government has important and powerful tools and methods for controlling the economy if control becomes necessary. But government is only part of the economic structure. Privately owned businesses and private citizens make up the largest part of our economic structure.

## SOME MAJOR ELEMENTS UNDERLYING THE GROWTH IN GOVERNMENT EXPENDITURES

Document 1: In his article, "The Growth of Government Over the Past 50 Years: An Analytical Review," Dr. Arnold M. Soloway attempts to outline the reasons behind the great growth in government's role in the economy since the turn of the century.

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Between 1900 and 1957 the population of the United States grew from 76 million to 170 million. Although a larger citizenry does not ordinarily require an equal proportionate increase in expenditures for all types of government activity, this population increase of 217 per cent obviously would itself call forth a sizable increase in aggregate government expenditures. For the period 1913-50, for example, it is estimated that population growth alone was responsible for \$4.6 billion, or 6.9 per cent, or the total government expenditure increase of \$66.4 billion...

The...rising price level has been another obvious influence raising the dollar volume of government expenditure. The long-period decline of the purchasing power of the dollar, in evidence since about 1850, has continued through the present...for the period as a whole, the purchasing power of the dollar has moved in a downward direction. For example, a 1939 consumer dollar had the purchasing power equivalent of \$2.58 in 1850, \$1.80 in 1900, and only \$0.52 in 1953...

Government expenditures in 1950 dollars increased 7.2 times from 1913 to 1950, while in current dollars the increase was 22.4 times. It is estimated also that 31.2 per cent of the total dollar increase...of government expenditures between 1913 and 1950 was due to price level changes alone. That is, some \$20.7 billion of a total 1950 expenditure of \$69.5 billion was due solely to the upward movement of prices since 1913.

Increased services was the greatest single cause of the rise in government expenditure over the past half century. The expansion of existing services and the introduction of new services alone cause a rise of \$27.1 billion...in government expenditure between 1913 and 1950. Thus, while population increase accounted for 6.9 per cent, the expanded scope of government services accounted for 40.9 per cent. The remaining 21 per cent of the increase in government expenditure is attributed to the interaction of all three causes: population growth, price-level change, and increased services.

## THE GROWTH OF GOVERNMENT TAX REVENUES AND EXPENDITURES

Document 2: In this reading from *Economics: Principles, Problems, and Policies*, Dr. Campbell R. McConnell gives his explanation for the increase in government expenditures in the twentieth century.

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In 1929 government expenditures claimed only about 8 per cent of total output. By 1939 this figure had expanded to 15 per cent. At the peak of the war effort in 1943-1944, government expenditures had expanded to 45 per cent of total output. In the uneasy peace of the postwar era, government expenditures have varied from 20 to 25 per cent of total output...The 20 per cent of total output purchased by government in 1960 was largely financed by an average tax bill of \$628 presented to every man, woman, and child in the United States!

The spectacular growth in government spending and, consequently, tax collections has a multiplicity of causes...root causes center around the desire of the citizenry to correct or alleviate the instability, inefficiency, and inequities which the price system of pure capitalism may foster. But more immediate causes are also abundant: (1) Hot and cold wars have sustained Federal expenditures at peak levels since 1940. War and national defense are the major causes of the phenomenal growth in government spending and taxing over the last two decades. (2) With population increases, more people require services from the various levels of government. (3) The public has demanded more and better...services to "match" the rising standard of living provided in the private sector of the economy. For example, we need better roads to accommodate more and better cars. (4) Inflation—generally rising prices—has forced government to spend larger and larger sums for given quantities of products...

From *Economics: Principles, Problems, and Policies* by Campbell R. McConnell. Copyright, 1963, McGraw-Hill Book Company. Used with permission of the McGraw-Hill Book Company.

## MONETARY POLICY AND BORROWERS

Document 3: The following is an excerpt from the *Federal Reserve Bulletin* of March, 1953. It explains the position of the Federal Reserve on the effects of its powers to regulate the economy.

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Credit and monetary measures have widespread effects in encouraging or discouraging expenditures. A general tightening of credit has its most direct effect in restricting the amount of spending with borrowed funds. Credit restraint also curbs the expansion of money, and so limits increases in the amount of cash balances held by individuals, businesses, and other spending groups.

Credit restraint, moreover, has important deterrent effects on spending out of existing cash balances and from funds obtained by the sale of assets, where no credit granting and no money creation are involved. These are indirect effects which come about in a number of ways. There may be a dampening of too optimistic expectations of businesses and consumers. A rise in interest rates produced by credit tightening will tend to reduce the value of capital assets, a development that will discourage some new investment in construction and producers' equipment. Consumers and businesses may decide to save more, either because they are less sure that credit will be available for possible emergencies or to ensure fulfillment of future plans, or because the interest return on savings has become more attractive.

Easing of credit, on the other hand, tends to have opposite effects. It encourages spending with borrowed money. It also stimulates greater spending out of current income and past savings. Credit easing does this by promoting the belief that prices of goods will rise, by reducing interest rates and thereby both lowering the cost of borrowing and stimulating a rise in capital values, and by making it less necessary and less profitable for businesses and consumers to save.

## Using Economic Methods

1. Using a blank piece of paper and a ruler, prepare a line graph illustrating the following information given in Dr. Soloway's article: "...the purchasing power of the dollar has moved in a downward direction."
2. Using a blank piece of paper and a ruler, prepare bar charts illustrating federal income and expenses as listed in Table 3.
3. Take the budget that you prepared for your use as you read Chapter 3. Add 2 percent as a sample sales tax on all items that you have planned to buy. What has this 2 percent sales tax done to your budget plans?

1850	\$2.58
1900	1.80
1939	1.00
1953	0.52

# ˈɛk-ə-ˈnām-iks

## Knowing Your Vocabulary

### *free enterprise*

/ˈfrē ˈent-ə(r)-prīz/

An economic system in which there is little direct regulation of the economy by the government. 105

### *progressive tax*

/prə-ˈgres-iv ˈtaks/

A system of taxation based on the amount of your income. The more money you earn, the larger the percentage of your income you will pay in taxes. 108

### *deduction* /di-ˈdæk-shən/

An amount of money allowed for certain items which may be subtracted from your income for tax purposes. 108

### *withholding system*

/with-ˈhōld-ɪŋ ˈsɪs-təm/

A system in which part of your taxes are held out of your wages by your employer. The employer deposits the tax money with the government. 108

### *regressive tax*

/ri-ˈgres-iv ˈtaks/

A tax in which you pay a smaller and smaller percentage of your income in taxes as your income increases. 109

### *bond* /ˈbænd/

Certificate which represents a loan of money to a government or business. Bondholders receive interest for the use of their money when bonds are redeemed. 109

### *open market operation*

/ˈo-pən ˈmār-kət ˌäp-ə-ˈrā-shən/

The purchase and sale of government bonds by the Federal Reserve System. 118



## Reading the Text

1. Name four important taxes that are collected by federal, state, or local governments.
2. What are the two ways that governments get their money?
3. What are some of the different ways governments can affect the economy?
4. Name three ways in which the Federal Reserve System can regulate the economy.
5. How does the Federal Reserve System decide to use its powers of regulation?

## Identifying Names and Terms

Excise Tax

I.C.C.

Federal Advisory Council

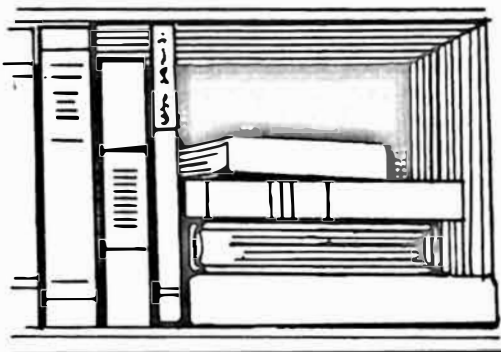
Federal Trade Commission

Internal Revenue Service

## Debating and Discussing Ideas

1. What does Dr. Soloway name as the causes of the growth of government expenditures? What are the reasons Dr. McConnell gives for the same trend? Why do you think government expenses have risen so greatly in the past several years?
2. What has been the major cause for the increases in federal expenditures, according to each economist? Is there a difference of opinion between Soloway and McConnell as to major cause? Why do you think that government expenses have risen so sharply recently? Before you answer, study the graph and tables in this chapter.
3. In Document 3 on page 122, the Federal Reserve explains what the effects of its regulatory policies might be. Do you think that the Federal Reserve is doing anything now to regulate the economy? If so, what would the Federal Reserve be doing? Study the newspapers

and news reports. Would the Federal Reserve be raising or lowering discount rates? What would they be doing in the open market? Would they be loosening or tightening credit at this time?



## Reading Other Sources

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Kreps, J. *Taxation and the National Debt*. New York: Holt, Rinehart and Winston, 1964.

Lasser, J. K. *Your Income Tax*. New York: Simon and Schuster, published annually.

Magruder, F.A. *American Government*. Boston: Allyn and Bacon, 1968.

# 7. Private Enterprise and Economic Growth

*Financial genius is a short memory  
and a rising market.*

John Kenneth Galbraith  
"1929 and 1969," Harper's



**What are the different forms of business organization?**

In our economic society there are three basic forms of business organization. These are the *single proprietorship*, the *partnership*, and the *corporation*.

Most people who go into business for themselves choose the single proprietorship. This is the oldest and the simplest form of business organization.

Suppose you have completed all of your education and the time has come for you to find a full-time job. After studying all of the possible jobs and professions that you are qualified for, you decide to go into business for yourself. You decide that Your Town needs a new pizza restaurant.

You withdraw all of the money that you have in the bank, plus \$1000 that you are able to borrow from your parents. With this money you are able to rent a building and buy or rent all of the equipment and supplies that you will need to start your restaurant. You not only own the business, you also work in it. You have set up a single proprietorship. You alone are completely responsible for the business. You alone will enjoy all of the profits. You alone will suffer all of the losses.

More than 80 percent of the businesses in the United States are single proprietorships. Single proprietorships are usually small businesses. Most single proprietors are doctors, dentists, lawyers,

farmers, or storekeepers of various types of small stores. Because of their size, they are the least important type of business by total yearly income.

Your restaurant is a great success. It is doing so well that you are beginning to worry about its future development. For one thing, you find yourself working at the restaurant almost all of the time. You would like some free time. You could also use more supplies, more dishes, and another oven to meet the demand for your product.

Although the restaurant is making a profit, it is not yet making enough money to buy the equipment that you need. Finally, your source of credit is gone. You have not been in business long enough for the bank to trust you with a loan. And your parents need their \$1000 back. You need help and you need capital, or money. You decide to take in some partners.

The partnership is the second most important form of business organization. In the partnership two or more individuals combine their money, talents, and work.

You ask four friends to become partners in your restaurant. They agree, and you draw up a partnership agreement. The partnership agreement, when signed and witnessed, becomes a legally-binding contract. Your partners agree to bring in some capital. They each put in five hundred dollars and agree to share in the work at the restaurant. In exchange for this,

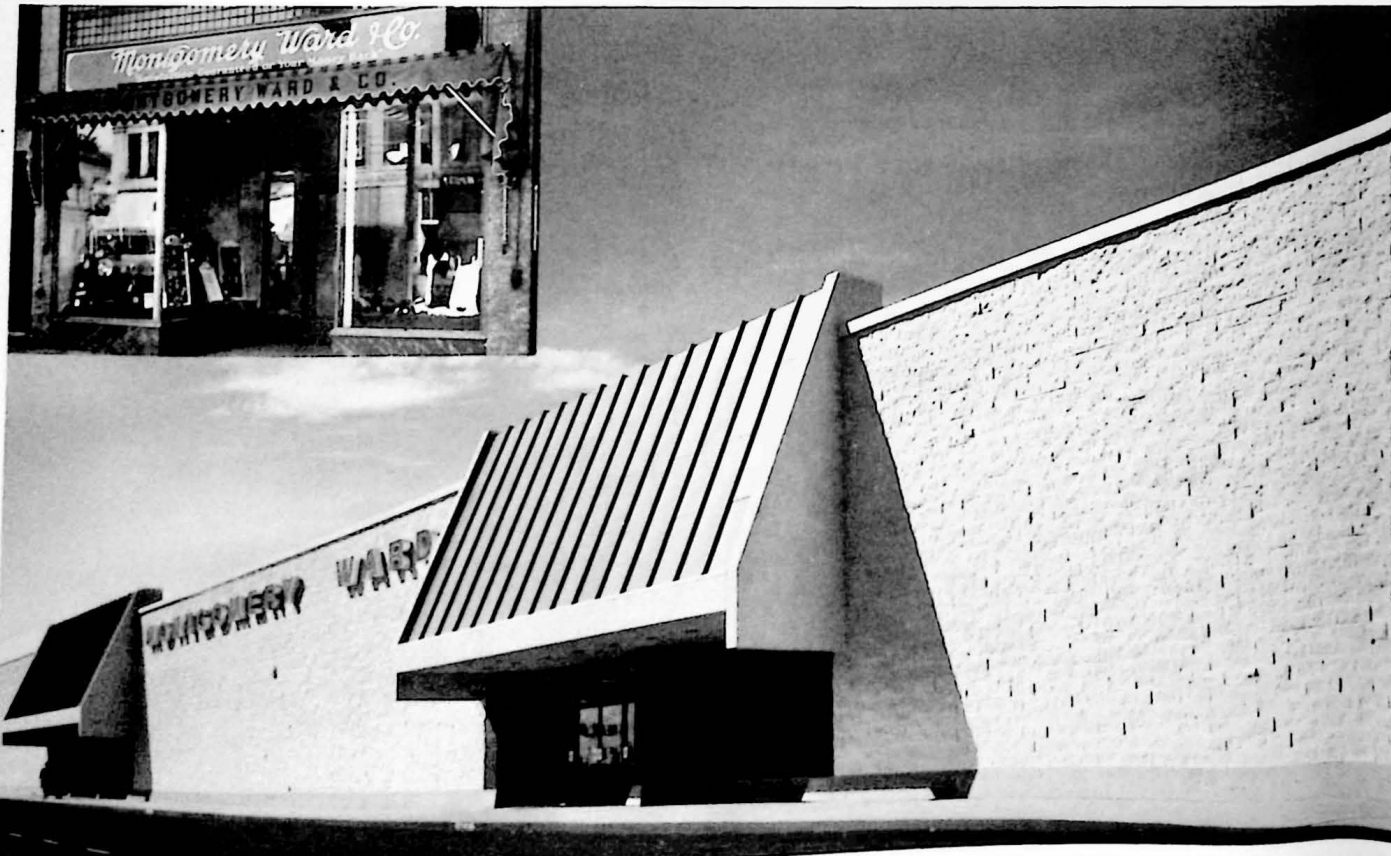
they become part owners of the restaurant. Each will now have a voice in the management of the restaurant. Each will now receive a share of the profits. Each one of your four partners will receive 19 percent of the profits. You, as the founder and senior partner, will receive somewhat more—24 percent of the profits. Each partner is also responsible for all the debts and losses of the business.

The restaurant continues to show a profit. Customers begin to ask for more variety in the menu. You need places to serve more customers. The more successful the restaurant is, the more capital you and your partners need for growth. Many of your friends, seeing the great success of the

restaurant, are anxious to buy into the business as partners.

However, you and your partners are unwilling to expand the partnership. There are many reasons for this. There are some disagreements among the present five owners over management of the business. More partners would only make this problem more serious. As the business grows and begins to take on more responsibilities and more debts, you and your partners begin to worry about your unlimited responsibility for those debts. To bring in more capital, to spread out the responsibility, and still to keep control, you and your partners decide to end the partnership. In its place you decide to form a corporation.

Through the exercise of wise management, many small businesses have grown into large corporations.



The most important form of business organization is the corporation. A corporation is a form of business organization which is owned by many people. These people are called *stockholders*. Stock is a share in the ownership of a corporation. Stockholders are people who have bought shares of stock in the corporation. Corporations produce and sell more goods, hire more employees, and spend and make more money than all other forms of business combined.

Some corporations are owned by a small group of people who usually also operate and manage the business. These small corporations are usually called "closed" or "family" corporations.

The largest and most powerful corporations are those that are owned by many thousands of individual stockholders. These big companies sell shares of their businesses. Owners, or stockholders, do not operate or manage the corporation. It is operated by a *board of directors* elected by the stockholders. This board of directors then hires business managers.

To form a corporation, you and your partners will first have to get a *corporation charter* from your state government. The corporation charter makes your corporation a legal body. The charter explains the purposes of your corporation. It is not very difficult to obtain a corporation charter in most states. The main requirement is that you be of *legal age*. In most

states this means that you have to be at least 21 years of age. For the payment of a small fee, a lawyer will draw up the necessary papers. Your state government will then grant you a charter almost automatically. Once you receive a corporation charter you are ready to sell shares of stock in your restaurant business.

You and your former partners add up the total value of your restaurant. You add the value of your building (the plant), the value of your stoves and dishes (the equipment), and the value of your stocks of food (your goods in process). These are your *total earning assets*. Let us say that these amount to \$10,200. To this amount you add \$9,800, which is the amount of capital needed. On this basis you decide to issue \$20,000 worth of stock in your new corporation.

You decide to issue 2,000 shares of stock at a price of ten dollars per share. You and your partners buy 51 percent of the shares with your earning assets from the partnership. The remaining 49 percent of the shares are sold to anyone who wishes to buy them. Each share of stock represents one vote in the management of the corporation. So although you and your former partners now share the ownership of your restaurant, you still have control of the management because you own most of the stock. You have now raised the money that you needed to expand your operations.

TABLE 1. ADVANTAGES AND DISADVANTAGES OF DIFFERENT BUSINESS ORGANIZATIONS

Advantages	Disadvantages
Sole Proprietorship	
<p>1. Simplicity: No complicated legal procedure to set up. The proprietor simply opens up shop.</p> <p>2. Flexibility: All business decisions are made by the sole proprietor. These decisions may be put into effect more quickly than in other business forms.</p>	<p>1. Limited funds: The size of the business is limited by the size of the owner's fortune and credit rating.</p> <p>2. Lack of specialization: Because of the small size of the business, the owner must do most of the work himself.</p> <p>3. Unlimited liability: All of the debts of the business become the personal debts of the owner.</p>
Partnership	
<p>1. Ease of formation: A partnership may be formed either by a legal written agreement, or by a simple oral agreement.</p> <p>2. Financial advantages: Two or more partners can raise more money and obtain more credit than one single owner can.</p> <p>3. Skills and talents: The work and responsibilities of the business can be shared among all the partners.</p>	<p>1. Unlimited liability: As in the proprietorship each member of a partnership is personally responsible for the debts of the business.</p> <p>2. Difficult to change partners: Whenever there is any change in membership, a new partnership must be formed.</p> <p>3. Ease of dissolution: A partnership may be ended whenever one of the partners wishes to end it.</p>
Corporation	
<p>1. Limited liability: Financial responsibility is limited to the value of the shares of stock.</p> <p>2. Permanence: Changes in stockholders will not affect the organization of the corporation.</p> <p>3. Transferability: Ownership can be transferred without difficulty. Stock may be sold at any time without affecting the corporation.</p>	<p>1. Lack of owner control: Especially in larger corporations where the ownership is divided between many thousands of owners, the control of the corporation is left in the hands of professional managers.</p> <p>2. Taxation: Corporations are taxed at a much higher rate than are other forms of business organizations.</p>

How did you convince people to buy the shares of stock in your company? You promised them a share of profits. If the corporation earns a profit it may declare a stock *dividend*. This is the stockholder's share of the profits. At

the end of each year, a percentage of the money the corporation made will be put aside for expansion and improvements. The remaining profits may be divided among all of the stockholders as an annual or quarterly dividend.

TABLE 2. WHO MAKES UP THE LABOR FORCE?

Skilled craftsmen:	carpenters, machinists, electricians
Unskilled craftsmen:	ditch-diggers, sanitation workers, store clerks, cashiers, file clerks
Executives:	corporation leaders, bank officers, sales managers
Professionals:	doctors, lawyers, teachers, professional athletes
Self-employed:	businessmen

While the owners may enjoy the profits of the corporation, they cannot be held responsible for all of the losses. If your corporation fails, the most that your stockholders, including you, can lose is the value of your shares of stock. This was not true of the partnership or the proprietorship. Then you and your partners were personally responsible for all the debts and losses of your business.

In a partnership or proprietorship you and your partners are the business. The corporation, however, is an organization separate from its managers and its owners. The corporation has its own name and own identity. According to law, it can make debts of its own. The corporation can sue. It can be sued. It can enter into contracts in its own name. Corporation obligations and debts are not those of the owners or managers of the corporation. If the corporation fails or has debts, only the total earning assets of the corporation

can be used to pay off its debts. The personal wealth of the owners or managers cannot be touched.

This great advantage of the corporation over other forms of business organization is known as *limited liability*. Each type of organization has some advantages and some disadvantages. Table 1 lists the most important of these advantages and disadvantages.

#### What part does labor play in the economy?

As we saw in Chapter 2, labor is one of the factors of production. The others are land, capital, and management. There can be no production unless all the factors of production work together.

Labor is the work performed by people to produce goods and services. In exchange for their labor, people receive money which helps them provide a living for their families and themselves. Table 2 lists some of the groups that are part of the labor force.

To find out if someone is a laborer, ask the following questions. If the answer is "yes" to both questions, the person is a member of the labor force.

1. Is the person's work done in order to make a living?
2. Does the person's work contribute to the production of goods and services?

By this definition, the word "labor" can be applied to all people who work for a living. The president of a large corporation can be described as a laborer as easily as can a factory worker.

However, we will be using the word "labor" in a narrower sense. We will separate labor, the doer, from management, the planner.

Labor can be divided into two groups—those workers who belong to a *labor union* and those who do not. A labor union is an organization of working men and women. While most factory workers belong to unions, few office workers do. However, this is beginning to change. Civil service workers, teachers, nurses, and other "white collar" groups have gradually begun to join or organize unions.

Labor unions are powerful organizations which help satisfy the economic and other needs of the members. There are two kinds of labor unions. One is a *craft union*. Craft unions are made up of skilled craftsmen. Each special skill has its own craft union. There are unions for machinists, plumbers, electricians, and teachers.

The second kind of union is the *industrial union*. The industrial union represents all of the workers in a certain industry. There may be many different jobs within an industry, but the industrial union represents them all. Examples of industrial unions are the automobile workers', mine workers', and steelworkers' unions. All of these unions are supported by dues that are paid by all their members.

Many craft and industrial unions are not independent of one another. Many of them are joined together into nationwide labor *federations*. A federation is an organization made up of separate, almost independent groups. Examples of labor federations are the American Federation of Labor (A.F. of L.), and the Congress of Industrial Organizations (C.I.O.). The A.F. of L. is a federation of craft unions. The C.I.O. represents industrial unions. In 1955 these two groups united to form the A.F. of L. - C.I.O. This huge federation is made up of 130 member unions with a membership of over 14 million workers.

The goals of labor unions are: 1) higher wages, 2) shorter hours, 3) better working conditions, and 4) *fringe benefits*. A fringe benefit is something extra paid for by the employer, such as health or life insurance.

The labor unions have been very successful in moving toward these goals. American workers are the highest paid in the history of

the world. Most of them have to work only eight hours a day to earn a living for themselves and their families. Many workers enjoy insurance benefits and safe retirement plans.

Furthermore, these gains have not been limited to just the union membership. Non-unionized workers have also seen their wages and benefits rise. Non-unionized industries have increased wages and benefits to keep workers from going to higher paying, unionized jobs in other companies.

In order to reach their goals, union officials meet with the management of the company to discuss wages, working conditions, and other labor problems. These meetings are called *collective bar-*

*gaining*. If the discussions are successful, they will result in a collective bargaining agreement. This is a legal contract explaining the results of the collective bargaining. It is signed by both the union officials and management.

If agreement cannot be reached through collective bargaining, the union may decide to *strike*. A strike is the refusal of a group of laborers to go to work. The strikers usually *picket* the company that they are striking against. This means that the striking workers march in front of the company's building. They also carry signs which explain why they have decided to strike. This is done to make the public aware of the union's disagreement with the management.

When collective bargaining breaks down, unions often resort to a strike to force management to meet union demands.



Management also has methods which it can use if collective bargaining breaks down. One of these methods is the *lockout*. During a lockout management closes the business. The laborers are not allowed to come to work. The lockout is not used often. However, management's threat to move the business to another city or state may succeed in getting the labor leaders to come to an agreement that is satisfactory.

What is the importance of investment to the worker and the economy?

The worker spends the largest part of his wages on the consumption of goods and services. Some of his wages are saved by the worker for his future needs.

How do people save money for their future needs? Money is saved by budgeting and by making careful consumer decisions. People do many things with the extra money that they have saved. Some people deposit this money in banks so it will earn interest. Other people invest their extra money. An *investment* is anything bought with the hope that its value will grow as time goes by. It is money spent to try to make a profit or gain an income.

People invest their extra money in many different things. Some people invest in property. Others invest in diamonds or in oil paintings. However, stocks or insurance are two of the most popular items in which people invest.

The *stock market* is an organized marketplace where stocks and bonds are bought and sold by investors. As you saw earlier, stock is a share in the ownership of a corporation. People buy stocks in order to receive dividends.

Bonds are the debts of corporations. Corporation bondholders are the creditors of corporations. Bonds represent loans from bond buyers to corporations. Bondholders expect to receive interest on their bonds. Stocks and bonds are also called *securities*.

Although there are stock markets in almost all of the major countries of the Western world, the biggest and most famous is the New York Stock Exchange. Inside all stock exchanges there are large trading floors. Securities are bought and sold on the trading floors. The buyers and sellers of securities are called *brokers*. Floor brokers work in the exchanges. Others work in brokerage firms all over the country. They conduct their business by telephone.

The price of securities is set by supply and demand. When many shareholders want to sell securities at the same time, the supply is high and the price goes down. When there are many buyers for some securities, the demand for them is high, and the price of the security goes up. Buyers compete for the lowest price. Sellers compete for the highest price. The securities are bought and sold when the two prices meet.

Great care must be taken when investing in securities. Securities have been rising in value for many years. But this rise in values has been stopped several times by serious drops in value. Stockholders who must sell their stocks in one of these periods suffer large money losses. Investment in securities may be very profitable. But it also carries with it the possibility of severe losses.

Not everyone invests in the stock market. Many people use their extra money to buy insurance. There are many different kinds of insurance. Most consum-

ers own some kind of insurance.

Some insurance policies are meant to protect the policyholder from a loss. Fire, theft, automobile, and life insurance all fall into this category. The consumer pays the insurance company a small sum of money periodically. This payment is called a *premium*. In exchange for these premium payments, the insurance company promises to pay for losses covered in the insurance policy. Without insurance, a family might lose its home, its possessions, or its means of support through death of the wage earner.

**TABLE 3. HOW CAN YOU READ NEWSPAPER REPORTS OF STOCK MARKET ACTIVITY?**

The daily report of the New York Stock Exchange is a mirror of business activity in the United States.

Conversion Table	
Fractional parts of a dollar	Value in cents
$\frac{1}{8}$	12½¢
$\frac{1}{4}$	25¢
$\frac{3}{8}$	37½¢
$\frac{1}{2}$	50¢
$\frac{5}{8}$	62½¢
$\frac{3}{4}$	75¢
$\frac{7}{8}$	87½¢
If a stock is listed at 15¼, the price per share is \$15.75. If it is listed at 2½, the price per share is \$2.62½.	

The prices on the stock exchange are usually stated in whole and fractional parts of a dollar. This conversion table shows the fractional parts of a dollar and their values.

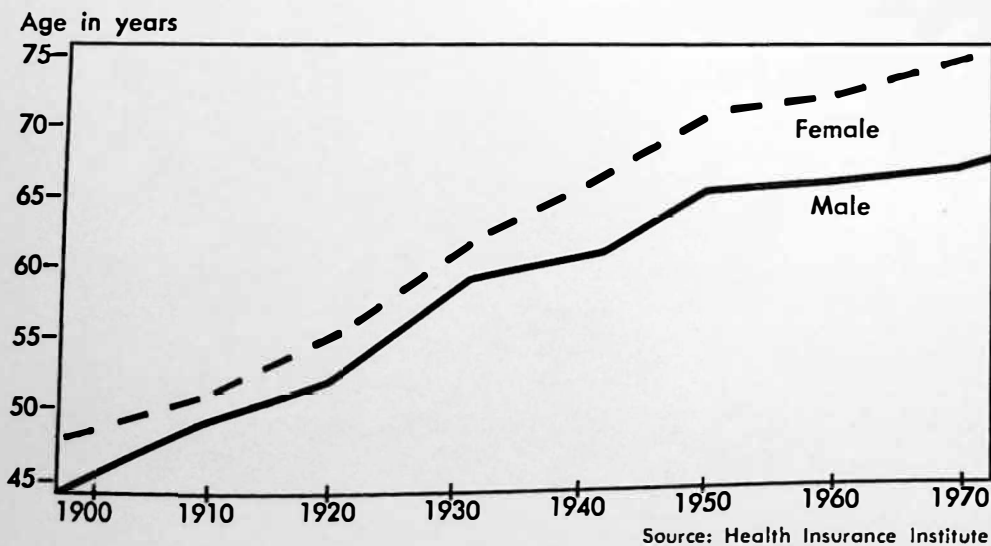
Stock	Sales In 100s	High	Low	Net (N.Y.)	Chg.	Stock	Sales In 100s	High	Low	Net (N.Y.)	Chg.
Gannett .48	10	36	36	36	+ ½	Lignit My 2.50	12	43 ½	43 ½	43 ½	0
GardDen 1.30	24	41 ½	41 ½	41 ½	0	Lilly Ell 1.40	15	110 ½	110 ½	110 ½	0
Garlock .80	2	19 ½	19 ½	19 ½	0	Lincoln Nat 2	5	79 ½	79 ½	79 ½	0
Gateway Ind	13	6 ½	6 ½	6 ½	+ ½	LincNl pf 3	7	81 ½	81 ½	81 ½	0
GCA Corp	6	10 ½	10 ½	10 ½	- ½	Ling Tem Vt	24	11 ½	11 ½	11 ½	0
Gemini Cap	4	18	18	18	0	LingTV AA	1	12 ½	12 ½	12 ½	0
GAOil .60b	27	41 ½	40 ½	41 ½	+ 1 ½	LingTV pf 5	28	24 ½	24 ½	24 ½	0
GATran 1.60	12	43 ½	43	43 ½	+ ½	Lionel Corp	3	4 ½	4 ½	4 ½	0
Gen Banc .56	17	14	14	14	0	LittonInd .50	410	24 ½	24 ½	24 ½	0
GnCable .80	111	21 ½	21 ½	21 ½	0	Litton pf 1	1	29 ½	29 ½	29 ½	0
Gen Cig 1.20	3	34 ½	34 ½	34 ½	+ ½	Litton cv pf 3	2	55 ½	55 ½	55 ½	0
GenDevel .32	15	26 ½	26 ½	26 ½	0	Litton pf B 2	11	29 ½	29 ½	29 ½	0
Gen Dynam	15	23 ½	23	23	0	Lockheed Air	22	10 ½	10 ½	10 ½	0
Gen Elec 2.60	66	95 ½	95 ½	95 ½	+ ½	Loew Thea 1	10	37 ½	37 ½	37 ½	0
Gn Firep .56b	3	10 ½	10 ½	10 ½	0	Londonw	1	13 ½	13 ½	13 ½	0
Gen Fds 2.60	19	88 ½	87 ½	88 ½	- ½	Lone SCem 1	555	27 ½	27 ½	27 ½	0
Gen Host	6	13 ½	13 ½	13 ½	0	LoneSr pf 4.50	1	115 ½	115 ½	115 ½	0
G Mill pf 1.75	1	54 ½	54 ½	54 ½	+ ½	LoneSGa 1.24	30	25	25	25	0
GenMot 3.40e	178	78 ½	78 ½	78 ½	- ½	LongisL 1.34	90	27 ½	27 ½	27 ½	0
IenMot Spf 5	3	62	61	62	+ ½	LIL pf B 5	210	9	9	9	0
GMof pf 3.75	3	61	60 ½	60 ½	+ ½	LIL pf 1 5.75	3	152	152	152	0
GenPCem .80	9	28 ½	28	28 ½	- ½	Loval Corp	2	45 ½	45 ½	45 ½	0
G PubUt 1.60	90	25 ½	25	25	0	La Land 1.95	183	69 ½	69 ½	69 ½	0
Gen Refract	11	13 ½	12 ½	12 ½	0	LouisNash 4a	8	62 ½	62 ½	62 ½	0
GenSignl 1.20	7	58	57 ½	58	+ ½	Lowensin .90	10	33 ½	33 ½	33 ½	0
GTEEl pf 2.50	5	40 ½	40 ½	40 ½	+ ½	Lubrizal .70	8	76 ½	76 ½	76 ½	0
Gen Tire 1b	84	24 ½	24 ½	24 ½	0	Lucky St .90b	17	35 ½	35 ½	35 ½	0
Genesco 1.70	161	31 ½	31	31 ½	+ ½	Ludlow 1.08	6	23 ½	23 ½	23 ½	0
Genstar .06	5	11 ½	11 ½	11 ½	+ ½	LukensStl 1	2	21 ½	21 ½	21 ½	0
GenulnPr .75	7	37 ½	37 ½	37 ½	- ½	Lums Inc	35	5 ½	5 ½	5 ½	0
GApacif .80b	44	58 ½	58	58	- ½	LVO Corp	10	61 ½	61 ½	61 ½	0
GApcf pf 1.40	1	57 ½	57 ½	57 ½	- ½	Lykes Yngst	47	8	8	8	0
Gerber 1.20	41	43 ½	43 ½	43 ½	+ ½	Lykes Yng pf	57	20 ½	20 ½	20 ½	0
GethyO 1.06e	28	76 ½	75 ½	76 ½	- ½	<b>M</b>					
GlanPC .20a	33	14 ½	14 ½	14 ½	- ½	MacAnF .20b	1	24 ½	24 ½	24 ½	0
Gibralr Fin	36	22 ½	21 ½	22 ½	+ ½	MacDonld .30	30	6 ½	6 ½	6 ½	0
Gidd Lewis	31	12 ½	12 ½	12 ½	0	Macke Co .30	8	11 ½	11 ½	11 ½	0
Gillette 1.4	24	47 ½	47 ½	47 ½	+ ½	Macke RH 1	51	34 ½	34 ½	34 ½	0
Gimbel Br 1	13	33 ½	33 ½	33 ½	0	Macy pf 4.25	210	61	61	61	0
Ginos Inc	16	19 ½	18 ½	19 ½	- ½	Mad Fd .75a	23	19	19	19	0
Glen Alden	7	77 ½	77 ½	77 ½	- ½	Mad Sq Gar	57	41 ½	41 ½	41 ½	0
GlenAl pf 2.25	1	32	32	32	0	Mad Sq Ch 5	51	27	27	27	0
Global Marin	60	14 ½	14 ½	14 ½	+ ½	Mad Sq Ch 5	51	27	27	27	0
Globe Un .90	11	15 ½	15 ½	15 ½	+ ½	Mad Sq Ch 5	51	27	27	27	0
Goodrich 1	52	29 ½	29 ½	29 ½	0	Mad Sq Ch 5	51	27	27	27	0
Goodv .85	563	31 ½	31 ½	31 ½	- ½	Mad Sq Ch 5	51	27	27	27	0
GorJwlrA .24	7	15 ½	15 ½	15 ½	+ ½	Mad Sq Ch 5	51	27	27	27	0
GouldInc 1.40	14	33 ½	32 ½	33 ½	- ½	Mad Sq Ch 5	51	27	27	27	0
Grace 1.50	28	32	31 ½	32	- ½	Mad Sq Ch 5	51	27	27	27	0
Granby 1.60	2	22 ½	22 ½	22 ½	- ½	Mad Sq Ch 5	51	27	27	27	0
GranUn .80	2395	27	26 ½	27	+ ½	Mad Sq Ch 5	51	27	27	27	0
Granville 1	32	25	24 ½	24 ½	+ ½	Mad Sq Ch 5	51	27	27	27	0
Grant W 1.50	44	45	45	45	0	Mad Sq Ch 5	51	27	27	27	0

Other insurance policies provide a means of investment. These policies are called *pension* or *annuity* plans. As Graph 1 shows, most people today live to a much older age than did their parents. How long can a male born in 1960 expect to live? How long can a female born in 1960 expect to live? These facts mean that you will probably live for some time after you have retired from working. Unfortunately, no work means no income, unless the worker or his employer has provided some means of support. In exchange for the periodic payment of premiums during the years when he is working, the consumer may invest in a pension plan. These plans will give the consumer an income for as long as he or she lives after retirement. The size of the income depends upon the amount the consumer is willing to invest in premiums during his or her working years.



Careful spending and wise investment during working years will mean a retirement free from financial cares and worry.

**GRAPH 1. YEARS OF LIFE EXPECTED AT BIRTH IN THE UNITED STATES**



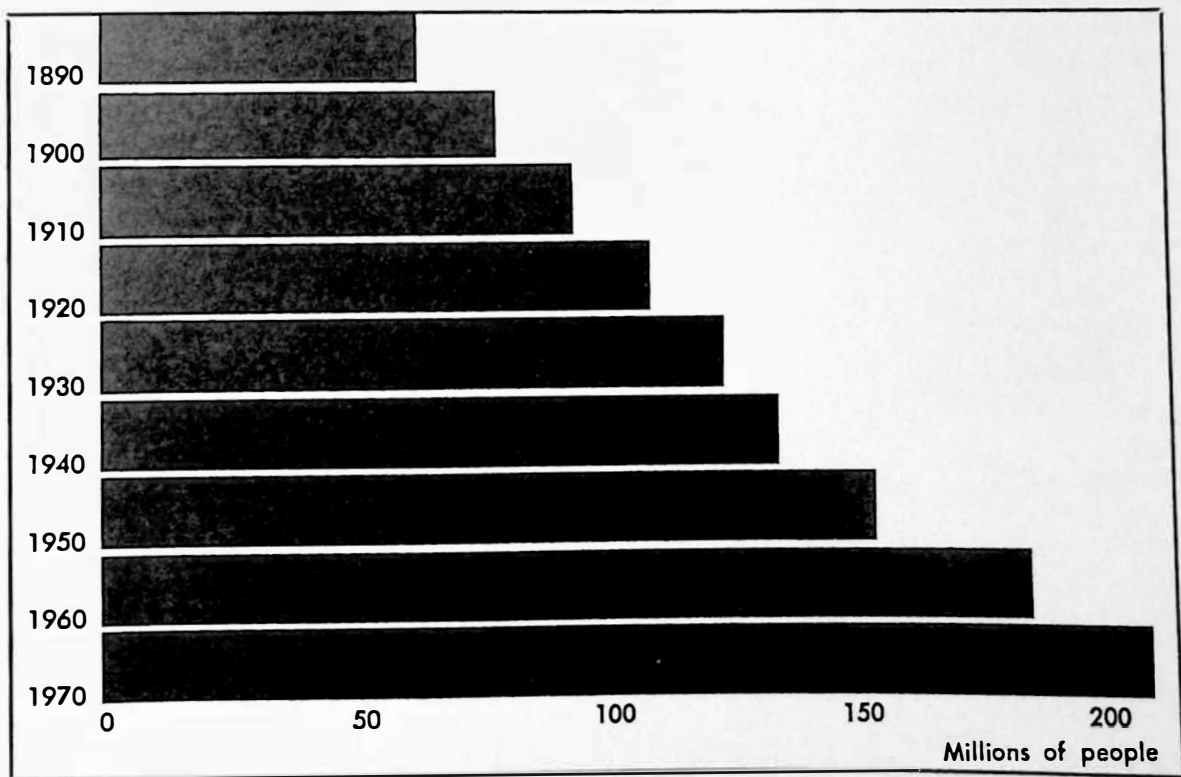
Investment is important not only to you. It is also important to business. Much of the money that you may decide to invest becomes the working capital of business. This capital is one of the important factors of production. Without capital, business could not be possible.

**What is the importance of economic growth?**

Two things must be happening if a nation is to experience economic growth. In the first place, the production of goods and services must be expanding. In the second place, the incomes of both producers and consumers must be rising gradually.

The size of our population has been growing steadily. So have the responsibilities of our nation. Our economy must grow to keep pace with rising demands. More and more goods and services must constantly be produced to satisfy the increasing demands of consumers and governments alike. More homes, more schools, more stores, and more factories must be built. More businessmen, teachers, electricians, and laborers in all skills must be trained. Jobs must be found for our unemployed. Aid must be provided for our poor. A reasonably comfortable retirement must be provided for our elderly. The needs of foreign trade and defense must be met.

**GRAPH 2. POPULATION GROWTH IN U.S.**



None of these things is easy to do without a steady rate of economic growth. A steady growth rate is not easy to achieve. Our economic society is constantly threatened by two things that can seriously upset the growth rate of any nation. These two things are *inflation* and *deflation*.

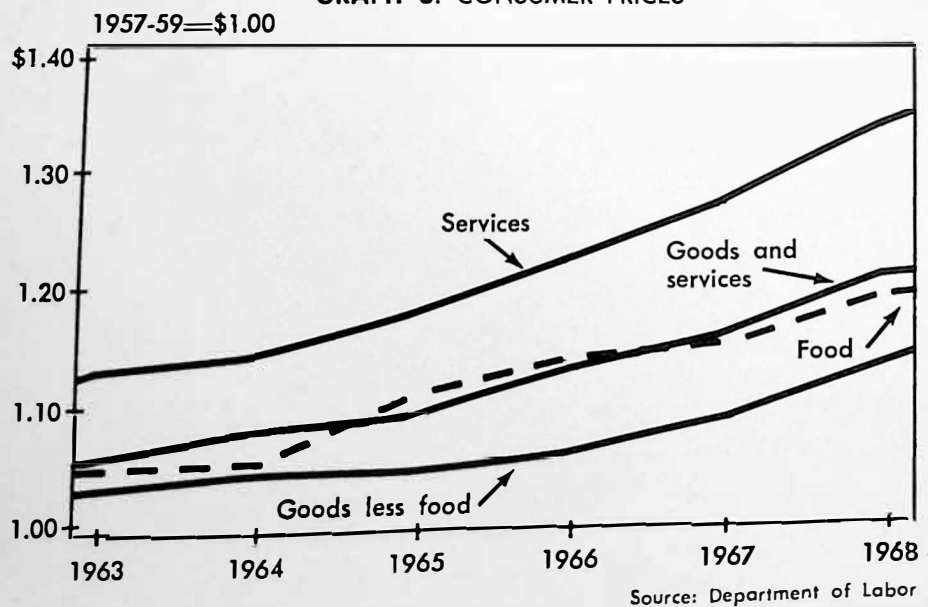
#### How are you affected by inflation?

A general rise in prices is sometimes called an inflation. The prices of many different consumer goods and services begin to go up. The consumer finds that he cannot buy as much with a dollar as he could before. Price increases cause workers to demand higher wages. Higher wages mean that businessmen will be faced with higher costs. This will cause businessmen to raise their prices again. There is a steady, upward movement of the general price level. The balance

between goods and purchasing power is upset. There is too much money trying to buy too few goods.

The term "inflation" may be used to describe either a general increase in prices, or the causes of a general increase in prices. Inflation often occurs during a war. A country at war uses all of its industries to try to win. This means few consumer goods are produced. Labor shortages develop as workers join the armed forces. Industry must pay high wages to hold workers. The government borrows money for the war effort, and the money supply grows. The end result will be an inflation. There is a lot of money in the hands of consumers, and there are too few consumer goods available for purchase. Since consumers will be able and willing to pay more for the few available goods, prices will rise. The value of money falls.

GRAPH 3. CONSUMER PRICES



## — INFLATION —

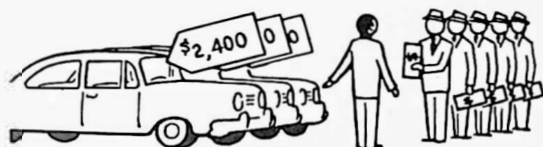
BUYING POWER LARGER THAN THE SUPPLY OF GOODS CAUSES . . .



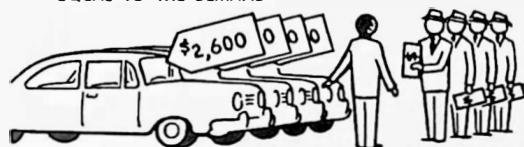
. . . AN INCREASE IN PRODUCTION AND PRICES



THE PRODUCTION AND PRICE WILL CONTINUE TO INCREASE . . .



. . . UNTIL THE SUPPLY IS EQUAL TO THE DEMAND

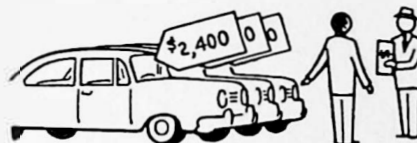


## — DEFLATION OR DEPRESSION —

A SUPPLY OF GOODS GREATER THAN THE BUYING POWER CAUSES . . .



. . . A DECREASE IN PRODUCTION AND PRICES. THIS DECLINE WILL CONTINUE . . .



. . . UNTIL THE SUPPLY IS EQUAL TO THE DEMAND



When inflation takes place, prices rise. During a deflation, prices fall. Neither is good for the economy of the nation.

Inflation can be a serious problem if it happens quickly. When a country experiences rapid inflation, many consumers are hurt. Those hurt the most, however, are the people on a *fixed income*. This means that their incomes will stay the same while the prices of goods continue to rise. Everyone must guard against inflation.

### How are you affected by deflation?

The effects of a deflation are exactly opposite to those of an inflation. When deflation takes place, prices fall. This is caused when the supply of goods equals or passes

the amount of money available to buy them. The supply of goods becomes greater than the demand for them. This means slowdowns in production, and unemployment. These periods of increasing unemployment we call *recessions*. Serious recessions we call *depressions*. During depressions prices are low. But this is balanced by the fact that many people are out of work because of cutbacks in production. These unemployed workers have little or no money to buy goods. Interest rates and profits fall. The values of investments in the stock market go down.

These price declines may be caused by many things. All are closely connected to less demand. Demand declines during periods of growing unemployment. Less demand may be caused by loss of jobs, reduced incomes, and changes in tastes, habits, or needs. Change in methods often results in labor-saving machinery which can cause unemployment. Problems in the banking system cause less credit to be available. Less credit will mean that businessmen and consumers will buy fewer goods. The after-effects of war will result in unemployment for returning soldiers and war-production workers.

Any one of these things can push a nation into a deflation.

A severe recession can become a depression. The Depression of 1929 put many people out of work and meant great hardship.

A rapid deflation can be harmful. The people who are hurt the most are those whose incomes depend on the production of goods. When production declines, they will have to take a cut in pay. Many of them will lose their jobs for a time.

In the United States, many things have been done to try to avoid both inflations and deflations. The Federal Reserve Board has some control over the size of the money supply. Banks insure deposits. Consumers do not have to fear losing their money if their banks fail during a deflation. The government can increase or decrease its spending to help avoid these economic situations.



## WHAT IS THE FUTURE OF THE UNION MOVEMENT IN THE UNITED STATES

Document 1: The author of this editorial from *Fortune* magazine (*Fortune*, LX, October, 1959) claims that labor unionism is beginning to decline in the United States. Do you think that unionism is losing its strength and support?

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The leaders of organized labor have seldom sounded so isolated, or so remote from reality, as they sounded this past month. Their Labor Day messages and their oratory at the A.F.L. - C.I.O. convention sought to create the impression that the principal problems facing labor were manufactured in the .... Congress...

What made those grandiose Labor Day speeches seem especially unreal was their attempt to portray the union movement as a rising tide; the Labor Day parade in New York, in which 100,000 unionists did actually march was also designed to create an impression of massive strength. Yet the fact is that union members are a dwindling minority in the United States. Membership fell from a peak of 17,500,000 in 1956 to about 17 million in 1958. Of course, the recession had a lot to do with this decline, but in 1959 membership had not picked up nearly so fast as employment.

Much of this decline has been caused by automation and the new technology of United States industry. The machines have displaced large numbers of semiskilled workers and at the same time have tended to "professionalize" many skilled workers, who are beginning to look more like technicians and to think more like white-collar workers. In short, the blue-collar men who have traditionally been the main "market" for union organization are becoming harder to find. In 1947 they made up forty percent of the labor force; today they amount to about thirty-seven percent, and by 1970 the figure will be down to thirty-one percent...Meanwhile there has been a marked increase in white-collar workers — who are notoriously poor union material...

But unfortunately for American labor not enough of its leaders appear to have the capacity to cope with this situation. Union leaders seem hardly aware that they are moving into a new and difficult phase of the movement's history, and that they can no longer count on the unquestioning sympathy and support of a large section of the public...

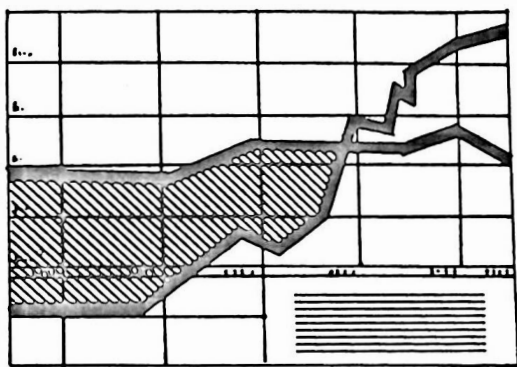
## INFLATION: WHAT ARE SOME OF ITS CAUSES? CAN IT BE CURED?

Document 2: John Kenneth Galbraith is one of the most famous and controversial economists in the United States. In this reading from his book, *The Affluent Society*, Galbraith presents what he thinks are the major reasons that inflation might strike an economic unit. He also questions the statement that increased production can stop an inflationary surge.

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Inflation—persistently rising prices—is obviously a phenomenon of comparatively high production. It can occur only when the demands on the economy are somewhere near the capacity of the plant and available labor force to supply them. When supply cannot be readily increased, as will be the case at capacity production, further increases in demand are capable of bringing price increases...At this point it is necessary to foreclose on what is perhaps the commonest error in contemporary attitudes toward inflation...This is the almost inevitable temptation to regard increased production as a remedy for inflation. It is the most natural of errors; the first thoughts on the matter are wonderfully simple... If inflation is caused by output pressing generally on capacity, then one need only get more capacity and more output and thus insure that this tension no longer exists. But as just a moment's further thought will suggest, additional all-round production, even when it can be readily obtained from existing capacity, will pay out, in wages and other costs, the income by which it is bought... the effect of increased production from existing plant capacity is to increase also the purchasing power to buy that production and the desires which insure that the purchasing power will be used...Thus the effort to increase production adds to the pressure on current capacity—and to the prospect for inflationary price increases.

A cat chasing its own tail may, by an extraordinary act of....dexterity, on occasion succeed in catching it. To overcome inflation by increasing production, while superficially similar, will not so often be successful.



C. How much did services that cost one dollar in 1959 cost in 1968?

ˈɛk-ə-nām-iks

## Using Economic Methods

1. Using Table 3 as a guide, convert the following stock values into cash values:  $12 \frac{7}{8}$ ;  $44 \frac{1}{2}$ ;  $16 \frac{3}{8}$ ;  $35 \frac{1}{8}$ .
2. Study the line graph on page 136 illustrating life expectancy in the United States. Answer the following questions:
  - A. How long could a male born in 1900 expect to live? How long could a female born in 1900 expect to live?
  - B. How much has the life expectancy of the American man increased from 1900 to 1967? How has it gone up for the American woman?
3. Study the line graph on page 138 illustrating the course of the prices of consumer goods and services from 1963 to 1968.
  - A. How much did a good that cost one dollar in 1959 cost in 1968?
  - B. What has gone up the most in cost, goods or services?

## Knowing Your Vocabulary

*single proprietorship*

/ˈsɪŋ-gəl p(r)ə-ˈprɪ-ət-ər-ship/

A business under direction and ownership of one person. 127

*partnership* /ˈpɑrt-nər-ship/

A legal relationship between two or more persons in a business. 127

*corporation* /ˌkɔr-pə-ˈrā-shən/

A business organization owned jointly by many people. 127

*board of directors*

/ˈbɔ(ə)rd əv də-ˈrek-tərz/

The elected representatives of the corporation stockholders. The board hires and oversees the managers of the corporation. 129

*corporation charter*

/ˌkɔr-pə-ˈrā-shən ˈchärt-ər/

A legal document from a state government granting permission to form a corporation. 129

*total earning assets*

/ˈtɒt-əl ˈər-nɪŋ ˈas-ɛts/

The total value of the plant, and of equipment and goods of a business. 129

*share of stock* /'she(ə)r əv 'stāk/

A certificate representing part ownership in a corporation. 129

*dividend* /'div-ə-dend/

A part of the profits of a corporation, paid periodically to stockholders. 130

*limited liability*

/ˈlɪm-ət-əd ˌlɪ-əˈbɪl-ət-ē/

The financial responsibility of the owners of a corporation is limited to the value of their shares of stock. 131

*labor union* /ˈlɑ-bər ˈyü-nyən/

An organization of working men and women, working toward better wages and working conditions for its members. 132

*craft union* /ˈkraɪt ˈyü-nyən/

A union composed of members who all share the same skill. 132

*industrial union*

/ɪnˈdæs-trē-əl ˈyü-nyən/

A union composed of members all employed in the same kind of industry. 132

*collective bargaining*

/kəˈlek-tɪv ˈbär-gə-nɪŋ/

Discussions held between union officials and management to settle labor problems. 133

*strike* /ˈstri:k/

A work stoppage ordered by a union to force management to agree to union demands. 133

*investment* /ɪnˈves(t)-mənt/

Anything bought with the hope that its value will grow. 134

*broker* /ˈbrō-kər/

A person who executes orders to buy and sell stocks or other investments (real estate, insurance, and so forth). 134

*premium* /ˈprē-mē-əm/

Money paid periodically to an insurance company in exchange for insurance coverage. 135

*pension plan* /ˈpen-çən ˈplan/

An insurance plan that provides the worker with an income after retirement in exchange for premiums paid by the worker during his or her working years. 136

*inflation* /ɪnˈflā-shən/

A general rise in prices and decline in the value of money caused by increased demand for a limited supply of goods. 138

*deflation* /diˈflā-shən/

A general decline in prices caused by a decreased demand for a large supply of goods. 138

*recession* /riˈsesh-ən/

A period of declining prices and growing unemployment. 139

*depression* /diˈpresh-ən/

A severe recession. 139

## Reading the Text

1. What are the three basic forms of business organization?
2. What are the advantages of the corporate form of business organization over others?
3. What are the goals of American labor unions?
4. What is a floor broker and what does he do?

## Identifying Names and Terms

A. F. of L.  
Stock Exchange  
Fixed income  
C.I.O.  
Securities

## Debating and Discussing Ideas

1. Organize a classroom discussion about price and wage controls as a possible way to end inflation. Do you think government restrictions on wages and on prices could affect inflation?
2. What does the reading from *Fortune* magazine declare to be the reasons behind the decline in the strength of labor unions in the United States? Do you think that the editors of *Fortune* magazine were right or wrong in their statement? Is

union strength declining or not? Study your local newspaper for evidence to support your answer.

3. Study the reading from Dr. Galbraith's book. Are we in an inflationary or deflationary period now? What do you think should be done by government, business, and you as a consumer to help try to control an inflation? A deflation?

## Reading Other Sources

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## 8. The Social Balance

*The economist, like everyone else,  
must concern himself with the  
ultimate aims of man.*

Alfred Marshall



**How are you important to the economy as a consumer?**

You are very necessary to the life of the economy when you act as a consumer. Your spending habits have great effects on the course of the economy. Your decisions to buy goods now instead of in the future can cause economic well-being. Your decisions to put off present spending can cause economic recession. The percentage of your present income that you decide to spend is called your *propensity to consume*.

Consumers with low incomes usually spend most of their incomes. They must spend just to get the necessities of life. Because they spend most of their income, the poor have a high propensity to consume. The well-to-do usually can save some part of their income. They have a lower propensity to consume. If income is shifted from higher income groups to lower income groups, consumption will increase. The low income groups will spend the money that probably would have been saved by the higher income groups.

Buying power is shifted to low income groups in several ways. Loans may be arranged by private financial institutions. Government programs may be used to shift buying power. Money obtained by taxation is given out by payments to the poor, social security payments, unemployment insurance plans, and some other government programs. This in-

creased buying power placed in the hands of more consumers helps keep up economic growth.

Your final decision to spend or not to spend is based on many things. Some of these things are:

1. The effects of advertising
2. The terms of credit
3. The size of a consumer's income
4. The length of life of expensive consumer goods
5. Expectations of future price rises or falls.

Convincing advertising may cause you to buy now. Poor advertising may cause you to wait before making your purchases. Easy credit terms can increase your willingness to buy in the present. The amount required as a down payment, the size of the interest charge, and the length of time you will be given to pay the loan off are all important factors. Your decision to spend may also depend on how difficult it is to set up charge accounts and get credit cards.

The size of your income is most important. Consumer spending will always increase in periods of increasing wages and increasing welfare benefits. When wages and benefits go down, so will consumer spending.

The length of life of durable goods decides how long you will be able to put off the purchase of replacements. Durable goods are among the most expensive goods that consumers have to buy. Automobiles, washing machines,

refrigerators, and furniture head the list of important durable goods. When durable consumer goods are built to wear out rapidly, the consumer buys new goods more often. The quality of durable goods can affect your decisions to buy or not to buy.

What you may expect future prices to be will affect your spending. If you expect the prices of goods to decrease in the future you will put off your purchases. If you think that prices will be higher in the future, you will be encouraged to buy today.

Your individual consumer decision to buy or not to buy and the decisions of many others like you are the most important decisions that can be made in the economic society. Most of our economic structure is used to discover, direct, and fulfill the wants and needs of the consumer.

Often the resources of the private sector are greater than those of the public sector. Many cars are made by the private sector every year.

**What is the social balance?**

America is the land of plenty. Skyscrapers, beautiful cars, fancy clothes, expensive toys, and millions of different goods surround us. At the same time, the news media tell us about traffic tie-ups, rising crime rates, air pollution, poverty, and growing trash heaps. Why are we unable to solve these serious problems? If our economic structure has the resources to produce so many consumer goods, why can't it clean the air, end poverty, and destroy the trash?

Part of the answer is that the economy is divided into two sectors, or sections. These are the private and the public sectors.

The private sector operates because of the profit motive. It has made billions of dollars worth of goods and services. The private sector expects to receive a profit from the sale of these goods and services.



On the other hand, the public sector usually operates on a non-profit basis. It produces public goods and services. Among these social goods and services are our police and fire protection, roads, parks, schools, libraries, and garbage disposal services.

The public sector receives little, if any, profit from the production and distribution of its goods or services. It is more attractive to make a profit than it is not to make a profit. Therefore, more of our resources are used for the private sector than are used for the public sector.

As the private sector expands, the public sector should grow with it. When the public sector fails to grow as fast as the private sector, the economy is out of social balance. Many times in the rush to produce more and more consumer goods, we may use too much of the nation's resources for the private

sector. There is social balance only when the supply of public goods is in balance with the supply of private goods.

When the social balance is upset, serious problems will result. An example of social imbalance has been the failure of state and local governments to modernize their highway systems. The public sector has been unable to build and improve roads fast enough to handle the number of new automobiles produced by the private sector. Every year millions of new cars appear on the roads. These powerful new autos are often forced to travel on unsafe and worn out roads. Cars with several hundred horsepower cannot travel more than a few miles per hour in or near cities. Highways are continuously clogged. It has become almost impossible to travel by car at a reasonable rate of speed during the commuter hours.

The construction of new highways by the public sector has not kept pace with the production of cars by the private sector.



This is just one example of what can happen when the social balance is upset. The same kind of thing happens every time pollution fills the air or the amount of poor housing increases in our cities. Until the social balance is at least partly restored, these problems will continue.

**What is the nature of the economic society?**

We live together in an economic society. Together, we are responsible for both the good and the bad effects of this society. Each time that we act as consumers, we affect the economic society. All of the economic decisions made every day move the economic society.

While the public sector has tried to speed the construction of housing, many inadequate homes still exist, often near new developments.

When inflation begins to push prices upward, it is partly because of our spending habits. When pollution spreads through the air and water it is partly because we would rather have more consumer goods than a cleaner environment. This is because all of the individual parts that make up the economic society are connected to one another. All parts of the economic society depend upon one another. No one part can stand alone.

The economic society is made up of three parts. These three parts are the consumer, the businessman, and the government.

Businessmen hire labor. They pay labor to produce goods. With wages they receive from business-

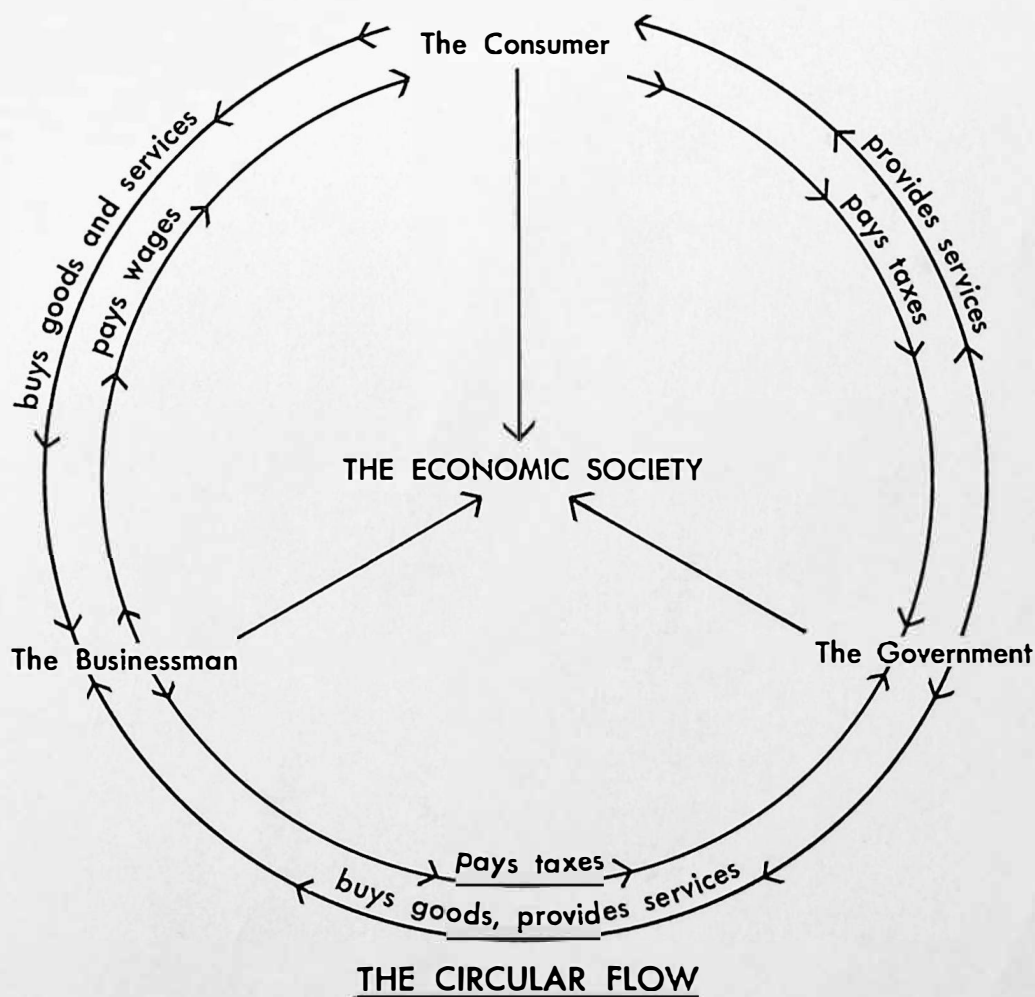


men, laborers become consumers. Producers, sellers, and consumers support government with part of their profits and wages. Government protects, regulates, and itself becomes a producer and consumer of goods and services, and a payer of wages. This flow of money, goods, and services is called the *circular flow*.

The economic society is this circular flow. When the flow is smooth the economic society advances toward a social balance. When the consumers, businessmen, or govern-

ments fail to make wise economic decisions, the flow is not even. The result is inflation, deflation, and other economic problems.

This makes your role as a consumer a very important one. All your economic decisions help govern the economic society. Unwise decisions can hurt not only you, but also many others. Wise economic decisions will help you enjoy your own life more fully. Your economic decisions can also help make a better life for everyone in our economic society.



# Summary of Major Ideas

A knowledge of economics and an understanding of the economic structure of the United States is of vital importance to everyone. On every day of his or her life, the individual is faced with many different economic problems, and must make many different decisions. Happiness or conflict may depend upon how well the problems are solved and how wisely decisions are made.

---

The most important economic problem facing consumers is how to satisfy limitless wants with limited means.

Consumers would like to buy many things. What they do buy is limited by the amount of money that they have to spend. This fact forces consumers who wish to live within their income to choose carefully what they will buy, and how much they will pay for it.

Consumer demand and its satisfaction are the bases of our economic structure and system.

Our economic structure is organized to fill the demands of consumers for goods and services. Consumer demand is satisfied by the interaction of the factors of production.

Careful planning and spending will help consumers use their money wisely, and enjoy their income to the fullest.

Since income is limited, consumers must try to spend the money they do have carefully and wisely. The way to do this is to plan all spending. Unwise use of money, spending more than can be afforded, can lead to serious financial difficulties.

**The production of goods and services depends upon the cooperation of the four factors of production.**

Goods and services are produced through the interaction of the factors of production. These are land, labor, capital, and management. Each must be present and perform its special task if successful production is to take place.

**Money's most important value is as a medium of exchange.**

Money is anything that is accepted by everyone as a medium of exchange. Down through history many different things have been used and accepted as money. Of the two values of money, its extrinsic and its intrinsic value, it is the extrinsic value that is more important.

**Financial institutions are concerned with the transfer of buying power from those who have to those who need.**

An important part of any economic structure is its arrangements for the transfer of buying power. Our financial institutions accomplish this task for us. Through loans and investments they channel needed buying power from consumers who have more than they need to consumers who need more than they have.

**The effects of the activities of all levels of government on the economy are growing rapidly.**

Government's effects on the economy are growing for many reasons, not the least of which is government's role as a regulator and a tax collector. But even more important is government's role as employer and consumer.

**Our economic structure is made up of many different but related parts and units.**

The circular flow of capital, credit, goods, services, wages, and taxes between business, consumers, and government makes up our economic structure. Economic problems result when the flow between the three parts is interrupted, or thrown out of balance.

## PRONUNCIATION SYMBOLS

By permission. From Webster's Seventh New Collegiate Dictionary, copyright 1967 by G. & C. Merriam Company, publishers of the Merriam-Webster Dictionaries.

a as in map  
ā as in day  
ä as in cot  
ǎ as in father  
au as in out  
b as in baby  
ch as in chin  
d as in did  
e as in bed  
ē as in easy  
f as in cuff  
g as in go  
h as in hat

i as in tip  
ī as in side  
j as in job  
k as in kin  
l as in pool  
m as in dim  
n as in no  
ŋ as in sing  
ō as in bone  
ô as in saw  
oi as in coin  
p as in lip  
r as in rarity

s as in less  
sh as in shy  
t as in tie  
th as in thin  
th as in then  
ū as in rule  
tr as in pull  
v as in give  
w as in we  
y as in yard  
z as in zone  
zh as in vision  
ə as in banana, collect

## Glossary

**acceleration clause** /ik-sel-ə-'rā-shən 'klóz/ A clause in an installment contract providing that, if a payment is missed, all of the remaining payments become due. 57

**balloon contract** /bə-'lūn-'kän-trakt/ A contract which provides for a very high final payment on an installment purchase. 57

**barter** /'bärt-ər/ Business conducted by an exchange of goods and not an exchange of money. 67

**budget** /'bəj-ət/ A plan for the spending of money. 45

**charge account** /'chärj ə-'kaunt/ An account opened with a store which allows a consumer to receive merchandise and pay for it at a later time. 52

**check** /'chek/ A written order demanding a bank to pay money as instructed. The bank is obliged to pay as long as there is as much money in the checking account as the amount of the check. 72

**collateral** /kə-'lat-ə-rəl/ Something of value given by a debtor to a creditor as security for a loan. 88

**commercial loan** /kə-'mer-shəl 'lōn/ A loan made to a business rather than to an individual consumer. 89

**commercial year** /kə-'mər-shəl 'yi(ə)r/ A length of time used by banks and businesses for the sake of convenience. The commercial year consists of 360 days, instead of 365 days. 86

**consumer** /kən-'sü-mer/ Anyone who buys or uses economic goods and services. 9

**contract** /'kän-trakt/ A legal agreement between two or more persons; having to do with things that each person promises to do in the future. 54

**credit** /'kred-ət/ Something that is entrusted to another, such as money or merchandise. 51

**debt** /'det/ Something owed by one person to another. 51

**deficit** /'def-ə-sət/ A shortage of money caused by spending more money than you make. 46

**deflation** /di-'flā-shən/ A general decline in prices caused by a decreased demand for a large supply of goods. 138

**demand deposit** /di-'mand di-'pāz-ət/ An account against which checks are written. The check "demands" that the bank pay money as instructed. 76

**depression** /di-'presh-ən/ A severe recession. 139

**down payment** /'daʊn 'pā-mənt/ First payment on an installment purchase. The down payment must be made in cash at the time of the purchase. 55

**due date** /'d(y)ü 'dāt/ The date on which a debt or bill must be paid. 53

**economic good** /,ek-ə-'nām-ik 'gūd/ Material object produced for use or sale. 12

**economic service** /,ek-ə-'nām-ik 'sər-vəs/ Useful work without producing material objects. 12

**economic structure** /,ek-ə-'nām-ik 'stræk-chər/ All things that make up the business life of a nation. 17

**economics** /,ek-ə-'nām-iks/ The study of how man earns his income and spends it to get what he wants or needs. 9

**extrinsic value** /ek-'strin-zik 'val-(,)yü/ The value as a medium of exchange given to anything being used as money. 71

**factors of production** /'fak-tərz əv prə-'dæk-shən/ Land, labor, capital, and management. These act together to produce goods and services. 32

**fiat money** /fi-,at 'mən-ē/ Cash that has no reserve of precious metals to back it up and does not have full value of precious metal in itself. Fiat money cannot be redeemed for standard money. 75

**finance charge** /fə-'nan(t)s 'chärj/ The interest charged for an installment purchase. 56

**free enterprise** /frē 'ent-ə(r)-prīz/ An economic system in which there is little direct regulation of the economy by the government. 105

**garnishment** /'gär-nish-mənt/ A court order allowing a company to use a wage assignment clause to collect a debt. 57

**income** /'in-kəm/ The money that you earn. 10

**inflation** /in-'flā-shen/ A general rise in prices and decline in the value of money caused by an increased demand for a limited supply of goods. 138

**installment contract** /in-'stól-mənt 'kän-trakt/ A contract that permits a customer to buy merchandise and pay for it in regular payments. 54

**interest** /'in-trəst/ A sum of money charged for the use of money. 51

**intrinsic value** /in-'trin-zik 'val-(,)yü/ The real value of a thing used as money. 71

**legal reserve** /'lē-gəl ri-'zərv/ The amount of money that a commercial bank must hold as a cash reserve. This amount is a percentage of the bank's total deposits. 90

**legal tender** /'lē-gəl 'ten-dər/ Paper cash and coins that the government has declared to be money. 74

- legally binding** /'l̩-gə-l̩ 'b̩n-dɪŋ/ An agreement, usually a contract, that you are obliged by the law to live up to. 55
- market economy** /'mār-kət i-'kän-ə-m̩/ An economy in which goods and services are offered for sale to the highest bidder. 33
- market price** /'mār-kət pr̩s/ The price at which supply and demand are in balance, and at which all of the goods offered for sale will be purchased. 37
- money** /'mən-ē/ Anything accepted by a society as a medium of exchange. 68
- mortgage** /'mɔr-gij/ A temporary claim placed upon the title or deed to a home. 88
- penalty clause** /'pen-əl-tē 'klɔz/ A clause in an installment contract which explains what will happen if the debtor fails to make his payments. 56
- principal** /'prin(t)-s(ə)-pəl/ A sum of money that is borrowed or saved. 86
- promissory note** /'präm-ə-s̩r-ē 'nɔt/ A borrower's written promise to repay a loan, plus interest, on a specified due date. 89
- recession** /ri-'sesh-ən/ A period of declining prices and of growing unemployment. 139
- repossess goods** /,r̩-pə-'zes 'gʊdz/ To take back goods from the consumer because he failed to pay for them. 55
- resource** /'r̩-s̩(ə)rs/ Something that is available to man for his use. 14
- secured loan** /si-'kyù(ə)rd 'lɔn/ A loan for which collateral of a similar value has been given. 89
- share of stock** /'she(ə)r əv 'stāk/ A certificate representing partial ownership of a corporation. 129
- standard coin** /'stan-dərd 'kɔin/ A coin which contains an amount of precious metal equal in value to the amount stamped on the coin. 74
- statistics** /stə-'tis-tiks/ The science which collects, arranges, and presents great amounts of information in such a way to make their study easier. 17
- table** /'tā-bəl/ An arrangement of information in rows and columns for easy reference. 17
- time deposit** /'t̩m di-'pāz-ət/ A bank account that is restricted as to the withdrawal of funds. Most banks ask for a written notice of withdrawal before money can be released. 83
- token coin** /'tō-kən 'kɔin/ A coin which contains precious metals that are worth less than the amount stamped as the coin's value. 74
- total earning assets** /'tot-əl 'ər-niŋ 'as-ets/ The total value of a business, its plant, equipment, and goods. 129
- unsecured loan** /,ən-si-'kyù(ə)rd 'lɔn/ A loan for which no collateral has been given. 89
- wage assignment clause** /'wāj ə-'s̩n-mənt 'klɔz/ A clause in an installment contract which allows a company to collect part of a debtor's wages from the debtor's employer until a debt is paid off. 57
- withholding system** /'with-'hɔl-dɪŋ 'sɪs-təm/ A system in which part of your taxes are held out of your wages by your employer and deposited with the government. 108

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Words found here in boldface type will also be found in the Glossary, where explanation and pronunciation are given.

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